Internal Revenue Bulletin

CUMULATIVE BULLETIN 1969-2

JULY-DECEMBER 1969

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Finding List of Obsolete Published Rulings [1]

(Rev. Proc. 67–6, C.B. 1967–1, 576)

The following is a complete list of rulings that have been declared obsolete during the year 1969 in accordance with the program announced in Revenue Procedure 67–6 for the review of rulings published prior to 1953.[2] (See C.B. 1967–2, page (X) and C.B. 1968–2, page (XIII), for a listing of rulings declared obsolete in 1967 and 1968 respectively.) The rulings are arranged by series in numerical order. Citations are to Cumulative Bulletins.

Cumulative Bulletin No. 1 contains rulings relating to income and profits taxes issued between April 1, 1919, and December 31, 1919. Similar rulings issued from January 1920 through December 1921 are contained in semi-annual Cumulative Bulletin Nos. 2, 3, 4, and 5. Other rulings issued during that period are contained in separate Sales Tax Rulings Bulletins.

All rulings published after 1921 are contained in the Internal Revenue Bulletin rather than in separate Income Tax and Sales Tax bulletins. Cumulative Bulletin I–1 covers the first six months of 1922, and each subsequent semiannual Cumulative Bulletin through the last six months of 1936 is similarly identified by a Roman numeral prefix and an Arabic numeral which denotes the first or the second half of the calendar year. Cumulative Bulletin 1937–1 inaugurated a new numbering system in which the year covered is identified by an Arabic numeral.

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[1] Declared obsolete by Revenue Rulings 69–30, 69–31, 69–43, 69–44, 69–45, 69–153, 69–271, C.B. 1969–1, pages 306, 307, 310, 312, 313, 314, and 357, respectively; Revenue Ruling 69–420, page 264, this Bulletin, and Revenue Ruling 69–661, page 265, this Bulletin.

[2] See Revenue Ruling 69–227, C.B. 1969–1, page 315, for a list of post-1952 rulings that are not considered determinative with respect to future transactions and have been declared obsolete.

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*Consideration limited to those of a ruling nature.

Items of General Interest

Propriety of Tax Court appearance by former Internal Revenue Services employees.

Chief Counsel Announcement 1969–1

The Tax Court on June 30, 1969, issued an opinion in *MacPherson-Sanford Trust* v. *Commissioner,* 52 T.C. No. 62, denying respondent's motion to disqualify a former employee of the Chief Counsel's office from representing petitioners as attorney in such matter.

On November 28, 1956, the Commissioner issued statutory notices of deficiency asserting that certain income was taxable to certain trusts. On the same day it issued statutory notices asserting alternatively that the same income was taxable to the settlor of such trusts. The trusts commenced the instant proceedings in the Tax Court to redetermine the trust deficiencies. The settlor, instead of instituting proceedings in the Tax Court, filed an injunction suit in a district court to prevent collection of the taxes asserted against him; such suit was dismissed by the district court and the settlor subsequently paid the assessments and filed suits for refund in the district court.

The record in the instant proceedings disclosed that the attorney involved, while employed by the Chief Counsel's office, assisted in preparing the government's defense of the injunction suit and participated in various proceedings to collect the taxes asserted against the settlor individually from both the settlor and the trusts as his transferee. Although defense of the Tax Court action involving the taxes asserted against the trusts were assigned to a different division of the Chief Counsel's office than that by which the lawyer involved was employed, the record in the instant proceedings disclosed that he participated in numerous conferences (some in his own office) in which both the district court and Tax Court actions were discussed together by various attorneys in the Chief Counsel's office and the Department of Justice. After his resignation from the Chief Counsel's office, the attorney involved entered his appearance in the Tax Court as counsel for the trusts.

Rule 2 of the Tax Court's rules of practice requires that practitioners before the Court carry on their practice in accordance with the letter and spirit of the canons of professional ethics as adopted by the American Bar Association. Canon 6 provides:

"The obligation to represent the client with undivided fidelity and not to divulge his secrets or confidences forbids also the subsequent acceptance of retainers or employment from others in matters adversely affecting any interest of the client with respect to which confidence has been reposed."

Canon 36 provides:

"A lawyer, having once held public office or having been in the public employ, should not after his retirement accept employment in connection with any matter which he had investigated or passed upon while in such office or employ."

Canon 37 further provides:

"It is the duty of a lawyer to preserve his client's confidences. This duty outlasts the lawyer's employment, and extends as well to his employees; and neither of them should accept employment which involves or may involve the disclosure or use of those confidences, either for the private advantage of the lawyer or his employees or to the disadvantage of the client, without his knowledge and consent, and even though there are other available source of such information."

The record further disclosed that on February 3, 1965, before filing his appearance in the instant proceedings, the attorney involved was directly advised by letter from the Regional Counsel in charge of the office in which he had been employed that there was no objection to the attorney's representation of the trusts nor even of the settlor in any of the tax cases then pending against them. The attorney thereafter not only entered his appearance in the Tax Court proceedings but participated in negotiations on the settlor's behalf to settle all the cases. The motion to disqualify was filed on January 4, 1967. After consideration of the various canons and the facts cited above, the Court denied the motion.

The Chief Counsel does not agree with any implication in the Court's opinion, that, absent such advice by the Regional Counsel, there would be no violations of the Canons of Ethics nor any prejudice to the Government by the attorney's representation of the trusts. *United States* v. *Trafficante,* 328 F. 2d, 117 (5th Cir. 1964); *T. C. Theatre Corporations* v. *Warner Brothers Pictures, Inc.,* 113 F. Supp. 265 (S.D. N.Y. 1953); and *Consolidated Theatres* v. *Warner Brothers C. M. Corporation,* 216 F. 2d 920 (2d Cir., 1954). Also see *United States* v. *Standard Oil Co.,* 136 F. Supp. 345 (S.D. N.Y. 1955). In view, however, of such advice, no appeal will be filed from the Court's order. Appropriate instructions have been issued to all Regional Counsel that in any case in which any question is raised as to the propriety of representation of a taxpayer in the Tax Court involving a former employee of the Chief Counsel's office, neither consent nor waiver of objections to such representation will be granted except by the Chief Counsel personally. In any such case involving a former employee of the Internal Revenue Service, who has not been employed in the Chief Counsel's office, neither consent nor waiver of objections to such representative will be granted except by the Chief Counsel personally with the personal concurrence of the Commissioner.

K. MARTIN WORTHY,
Chief Counsel.

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.
C.T.—Carriers Taxing Act of 1937.
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.I.C.A.—Federal Insurance Contributions Act.
F.R.—Federal Register.
F.U.T.A.—Federal Unemployment Tax Act.
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.
PS—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** are used to represent certain numbers and when used with the word "dollars" represent sums of money.

Foreword

The Internal Revenue Cumulative Bulletin is prepared in five parts as follows:

Part I.—1954 Code. This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954 other than those pertaining to alcohol, tobacco, and firearms.

Part II.—1939 Code. No rulings or decisions based on provisions of the Internal Revenue Code of 1939 and other laws were published during the period July–December 1969.

Part III.—Alcohol, Tobacco, and Firearms. This part is divided into two subparts as follows: Subpart A, alcohol matters issued under Chapter 51 of the Internal Revenue Code of 1954 and under the Federal Alcohol Administration Act; Subpart B, tobacco matters issued under Chapter 52 of the Internal Revenue Code of 1954.

Part IV.—Treaties. This part includes Revenue Rulings relating to Tax Conventions. (Public Laws pertaining to internal revenue matters enacted by the 91st Congress, 1st Session, on or after June 30, 1969, together with related Committee Reports, normally included in this Part of the Cumulative Bulletin, have been consolidated and are published in Cumulative Bulletin 1969–3.)

Part V.—Administrative, Procedural, and Miscellaneous. To the extent practicable, pertinent cross-references to these subjects are contained in the other Parts and Subparts. Included in this Part is a list of persons disbarred or suspended from practice before the Internal Revenue Service.

The synopses preceding Revenue Rulings, Revenue Procedures, and Court Decisions are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

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 of general interest.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, industry regulations appearing in internal management documents and statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue Rulings represent the conclusions of the Service on the application of the law to the entire state of facts involved. In those that are based on positions taken in rulings to taxpayers or technical advice to service field offices, identifying details and confidential information are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements, such as 18 U.S.C. 1905 and 26 U.S.C. 7213 concerning disclosure of information obtained from members of the public.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

Cumulative Bulletin 1969–2 is a consolidation of all items of a permanent nature published in the weekly Bulletins 1969–27 through 1969–52 for the period July 1 through December 31, 1969. It includes a cumulative list of announcements relating to decisions of the Tax Court of the United States published in the Internal Revenue Bulletins.

Public Laws pertaining to internal revenue matters enacted by the 91st Congress, 1st Session, on or after June 30, 1969, together with the related Committee Reports, have been consolidated and are published in Internal Revenue Cumulative Bulletin 1969–3.

The Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of five Services: 1—Income Tax, 2—Estate and Gift Taxes, 3—Employment Taxes, 4—Excise Taxes, and 5—Alcohol, Tobacco, and Firearms. Each Service is composed of a basic volume and a cumulative supplement. The supplements are issued quarterly for Service No. 1 and semiannually for Services 2 through 5. The system provides finding lists and topically-arranged digests of the items published in the Bulletin.

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, 1969, to December 31, 1969, 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 on 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 Commissioner ACQUIESCES in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Abbott, Frank H., et ux	2659–63	47	399
Angelus Funeral Home [3]	4217–64	47	391
Archbold, John D.[2 4]	[a]97142	42	453
Aspegren, Oliver R., Jr., et ux	7142–65	51	945
Bail Fund of the Civil Rights Congress of New York [5]	52209	26	482
Bolt, Lincoln Adolphus	3863–67 5261–67	50	1007
Borner, A. Carl, estate of [1 6] Borner, Bertha J., executrix of estate of A. Carl Borner [1 6]	39669	25	584
Brandon, Alfred C., Jr., et ux	2661–63	47	399

See footnotes at end of table.

Taxpayer	Docket No:	Report Volume	Page
Breidert, George M., et ux	256–67	50	844
Brockway, Don Murillo, estate of [16]	24446	18	488
Brooks, Harold S., estate [1]	2624–66	50	667
Brown, S. E. [27]	6578–66	52	50
Brown, William A	3947–62	47	399
California Thoroughbred Breeders Association [8]	5415–64	47	335
Cardinal Corp., The (formerly Cardinal Life Insurance Co.)	4778–64	52	119
Carnall, Edward, estate of [16]	39556	25	654
Chown, Harriet H., estate of [1]	3233–67	51	140
Chown, Roger M., estate of [1]	3232–67		
Conlorez Corp	6746–66	51	467
Cordeiro, Mary, executrix, estate of Tony Cordeiro.	3755–66	51	195
Cordeiro, Tony, estate, and Mary Cordeiro, individually and executrix	3757–66		
Davis, Howard Lee, estate of [1]	5859–66	51	269
Delta Sheet Metal & Air Conditioning, Inc	5335–66	50	203
Dixie Beverage Co. of Charleston, Inc	2835–67	49	353
Dixon, Grady C., et ux	2660–63	47	399
Farcasanu, Louisa B. Gunther	3533–62	50	881
Federation Bank & Trust Co	59697	27	960
Ferrill, Joseph H., et ux	2562–63	47	399
Feuer, Cy, et ux	5014–64	50	341
Fischer, C. Fink, et ux	990–66	50	164
Frankfort, Fred, Jr., et ux	1504–67	52	163
Gaddy, J. W., et ux [9]	90213	38	943
Garrison, Joseph, et ux	5405–67	52	281
Greenman, Frederick F., liquidating trustee of Bail Fund of the Civil Rights Congress of New York [5]	55209	26	482
Harris, Cleveland J	449–68	51	980
Hodges, Hugh H., et ux	1669–66	50	428
Hornor, Julia Crawford, estate of [1]	77153	36	337
Jefferson, Theodore B.[7]	3585–67	50	963
Jones, Ione Davis, executrix of estate of Howard Lee Davis [1]	5859–66	51	269
Jorg, Robert W	502–69SC	52	288
Lage, Walter G., et ux	6487–66	52	130
Landreth, George H., et ux	2976–65	50	803
Leventis, P. P., Jr., et ux	2834–67	49	353
Magic Mart, Inc [7]	6512–66	51	775
Martin, Ernest H., et ux	5013–64	50	341
Mathias, Eugene P., et ux	406–66	50	949
Mayerson, Manuel D., et ux [10]	2969–64	47	340
McBride, Andrew F., Jr., et ux	6044–66	50	1
Miller, Nicholas C	5977–65	49	484

See footnotes at end of table.

Taxpayer	Docket No.	Report	
		Volume	Page
Municipal Bond Corp., The	85810	46	219
Novak, Syd, et ux	2308–66	51	7
Nye, George A., et ux	5333–66	50	203
Osrow, Harold, et ux	185–66	49	333
Osrow, Leonard, et ux	160–66		
Owens, Robert E., Jr., et ux	2050–63	47	399
Parker, Wilmer, Jr., et ux	1681–66	50	428
Parsons, William H., et ux	81746	43	378
Peters, Edna V. T., estate of,[1] T. Graham Peters, executor	4203–64	46	407
Polk, Frank, et ux [11]	65082	31	412
Producers Chemical Co.[12]	175–66 1873–67	50	940
Provident Trust Co. of Philadephia, et al., executors of estate of Edward Carnall [16]	39556	25	654
Reise, Elmer [7]	69698	35	571
Rink, Ernest L., et ux	2643–67	51	746
Santa Anita Consolidated, Inc. (formerly Los Angeles Turf Club, Inc.)[13]	3577–65	50	536
Seraydar, Rose D	2023–66	50	756
Shepherd Construction Co., Inc	4585–66	51	890
Smith, Clarence W., et ux	2554–67	51	1
Somers, Howard B., executor, estate of Harriet H. and Roger M. Chown [1]	3233–67 3232–67	51	140
Struikmans, Henry, et ux	3756–66	51	203
Thornton, Dale, et ux	5334–66	50	203
Town and Country Food Co., Inc	3177–63 2619–66	51	1049
United States Mineral Products Co	4733–66	52	177
Vander Hoek, Ralph, et ux	3754–66	51	203
Wadlinger, F. Raymond, et al., executor of estate of Julia Crawford Hornor [1]	77153	36	337
Wells, Glenn L., et ux	1670–66	50	428
Wells, Leslie, et ux	1682–66		
White, John P., et ux	4281–65	48	430
Willits, Oliver G., et ux	1715–66	50	602
Wood, Clarence, et ux	85316	37	70
Woodbury, Glenn A., et ux	4353–65	49	180
Woodbury, Leo A	4352–65		
Woodbury, Leo A., et ux	4354–65		

See footnotes at end of table.

The Commissioner does NOT ACQUIESCE in the following decisions:

Taxpayer	Docket No.	Report Volume	Report Page
Court Holding Co.[14]	111075	2	531
Decker, John A., et ux.[15]	69496	32	326
Decker, Mary J., executrix of estate of William E. Decker, and individually [15]	69497		
Decker, William E., estate of [15]			
Doering, Otto C., Jr., et ux	87757	39	647
Gaddy, J. W., et ux.[16]	90213	38	943
Lytle, Barbara Ann, administratix of estate of Pauline E. Nock	7258–65	49	263
Marshall, Charles D., et al., executors, estate of Dora N. Marshall [2]	1178–68	51	696
Marshall, Dora N., estate of [2]			
Nock, Pauline E., estate of	7258–65	49	263
Reichert, James W., et ux[15]	69498	32	326
Reichert, John F., III, et ux.[15]	69499		
Salkov, Abraham A., et ux	5892–64	46	190

[a] United States Board of Tax Appeals.

[1] Estate Tax decision.

[2] Gift Tax decision.

[3] Acquiescence is specifically limited to the particular facts and circumstances of this case; i.e. preneed service contracts involving funeral arrangements.

[4] Nonacquiescence published in C.B. 1965–2, 7, withdrawn and acquiescence in result only is substituted therefor. 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.

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

[6] Nonacquiescence published in C.B. 1962–2, 6, is withdrawn and acquiescence is substituted therefor.

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

[8] Acquiescence in result only. Acquiescence "in result only" means acceptance of the decision of the Court but disagreement with some or all the reasons assigned for the decision. See Rev. Rul. 69–247, C.B. 1969–1, 303.

[9] Acquiescence in the issue relating to whether the receipt of $24,411.89 under a rental agreement was received under a claim of right in 1957.

[10] See Rev. Rul. 69–77, C.B. 1969–1, 59.

[11] Nonacquiescence published in C.B. 1959–2, 8, withdrawn and acquiescence is substituted therefor. Acquiescence relates only to section 122(d)(5) of the 1939 Code and not to anything the Tax Court may have implicitly decided about section 22(n)(1) of the 1939 Code.

[12] Acquiescence in the issue relating to whether fracturing costs should be considered as a development cost under facts of that case.

[13] Acquiescence in result only in the issue that petitioner is entitled to an ordinary loss, deductible under section 165(a) of the Code, on payment for its release from a guaranty obligation. Acquiescence relates to the issue of the long-term capital loss with respect to investment in stock of Pacific Ocean Park, Inc.

[14] This announcement is made to correct an error in footnoting in the Cumulative List of announcements in C.B. 1968–2, 3. The decision should have been referenced to footnote No. 14 which reads: Acquiescence published in C.B. 1943, 5, with respect to issue No. 1 relating to prepaid interest, is withdrawn and nonacquiescence is substituted therefor. See Rev. Rul. 68–643, C.B. 1968–2, 76.

[15] Acquiescence in result only published in C.B. 1964–2, 5, is withdrawn and nonacquiescence is substituted therefor. See Rev. Rul. 69–608, page 42, this Bulletin.

[16] Nonacquiescence in the issue relating to whether the Court may reject the concession by the petitioners that $14,990.01 was taxable in 1957.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954, Except Those Pertaining to Alcohol, Tobacco, and Firearms

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 37.—Retirement Income

26 CFR 1.37–4: Limitation on amount of retirement income.

A calendar year taxpayer whose 72d birthday falls on January 1 is entitled to the retirement income credit for the prior taxable year regardless of the amount of earned income he received.

Rev. Rul. 69–422

A taxpayer's 72d birthday was on January 1. He filed his Federal income tax return on the basis of a calendar year accounting period. *Held,* for purposes of computing his retirement income credit under section 37 of the Internal Revenue Code of 1954, the taxpayer became 72 years of age the day before his 72d birthday and thus he had attained the age of 72 before the close of his prior taxable year. Therefore, provided he otherwise qualifies, the taxpayer is entitled to the retirement income credit for that year regardless of the amount of earned income he received.

Section 39.—Certain Uses of Gasoline and Lubricating Oil

Method by which a nonresident owner of aircraft registered in a foreign country may obtain a payment in the amount of the gasoline or lubricating oil tax paid on these products where the products are used for certain nonhighway purposes. See Rev. Rul. 69–406, page 261.

Subpart B. Rules for Computing Credit for Investment in Certain Depreciable Property

Section 46.—Amount of Credit

26 CFR 1.46–2: Carryback and carryover of unused credit.
(Also Section 6501; 301.6501(a)–1.)

Assessment and collection of deficiencies resulting from the disallowance of investment credit carryovers can be made even though the year in which the investment credit was incorrectly claimed is barred by section 6501(a) of the Code.

Rev. Rul. 69–543

Advice has been requested whether, under the circumstances described below, investment credit carryovers can be disallowed and a deficiency assessed and collected as a result of such disallowance.

The taxpayer, a corporation, commenced business in 1965. In its Federal income tax return for 1965, the taxpayer claimed an investment credit of $100x$ dollars with respect to certain property placed in service by it in that year. However, the $100x$ dollars credit exceeded the limitation on the amount of credit allowed for 1965 (section 46(a)(2) of the Internal Revenue Code of 1954) by $35x$ dollars. Pursuant to the provisions of section 46(b) of the Code, the $35x$ dollars of "unused credit" was carried over to 1966, 1967, and 1968 and claimed as credits in those years in the amounts of $5x$ dollars, $10x$ dollars, and $20x$ dollars, respectively.

In 1969, more than three years after the taxpayer filed his 1965 returns, the taxpayer's returns for 1966, 1967, and 1968 were examined by the Internal Revenue Service and it was determined that the property with regard to which the $100x$ dollars investment credit was claimed did not qualify for investment credit purposes when placed in service in 1965. Under the provisions of section 6501(a) of the Code a deficiency based on the determination that no investment credit was allowable in 1965 cannot be assessed or collected for such year.

The specific question presented is whether section 6501(a) of the Code prevents the assessment and collection of deficiencies resulting from disallowance of the investment credit carryovers because the year in which the investment credit (to which the carryovers relate) was claimed is barred by section 6501(a) of the Code.

In situations involving loss carryovers it has been held that the statutory provision now contained in section 6501(a) of the Code does not bar the assessment or collection of deficiencies for years not affected by section 6501(a) of the Code which result from a determination that the transaction giving rise to such carryovers was incorrectly reported in a year barred by section 6501(a) of the Code. See, for example, *Stephen J. Hajos* v. *Commissioner,* T.C. Memo. 1964–328; *Clarence J. Simon* v. *Commissioner,* T.C. Memo. 1960–34; *Lord Forres* v. *Commissioner,* 25 B.T.A. 154 (1932). Similarly, in cases involving investment credit carryovers section 6501(a) of the Code does not bar the assessment or collection of deficiencies for years not affected by section 6501(a) of the Code which result from a determination that the investment credit to which the carryovers relate was incorrectly claimed in a year barred by section 6501(a) of the Code.

Accordingly, it is held that the investment credit carryovers claimed by the taxpayer on its 1966, 1967, and 1968 returns can be disallowed and the deficiencies resulting therefrom can be assessed to and collected from the taxpayer.

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26 CFR 1.46–2: Carryback and carryover of unused credit.

Carrybacks of unused credit to 1962 and carryovers of unused credit from 1962 by mutual casualty insurance company. See Rev. Rul. 69–603, page 7.

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26 CFR 1.46–3: Qualified investment.

Qualification of an electric generating power plant and related structures and equipment as "section 38 property" for investment credit purposes. See Rev. Rul. 69–412, page 2.

Section 48.—Definitions: Special Rules

26 CFR 1.48–1: Definition of section 38 property.
(Also Section 46; 1.46–3.)

Qualification of a modern electric generating power plant and related structures and equipment as section 38 property for investment credit purposes.

Rev. Rul. 69–412

Advice has been requested whether, under the circumstances described below, a taxpayer's modern steam generating electric power plant of 750-megawatt capacity qualifies as "section 38 property" that is "public utility property" for investment credit purposes.

The taxpayer's plant consists of boilers to convert fossil fuel energy into steam energy, turbines to convert steam energy into mechanical energy, and generators to convert mechanical energy into electricity.

Modern steam power plants of 300-megawatt capacity or larger are designed and built on the unit principle. One steam generating component (boiler) supplies steam to one turbine generator component with no interconnection with other units in the same station. Unlike older types of stations in which a bank of boilers fed steam to a turbo-generator and were cross-connected to serve other units in an emergency or outage, the modern unit has a single boiler, tailored and designed specifically for the turbo-generator to which it is connected. When either the boiler or the turbo-generator is retired from service the remaining component will also be retired from service. However, auxiliary equipment (such as pumps, motors, valves, relays, heat exchangers, etc.), can be and is replaced at the end of the useful life of such equipment.

In designing the structure to surround and support the required units, the size and type of turbine generators are the initial factors to determine the size and dimensions of the turbine foundations. Exact alignment and freedom from vibration are essential to the reliable operation of the turbine generator. The turbine foundation must provide for the contained condenser. Therefore, turbine foundations are massive (up to 800 tons) reinforced-concrete pedestals the size of which, in turn, determines the length and width of the turbine room structure and the structural steel framework for the turbine room crane of up to 250-ton capacity.

The steam generating equipment (boiler) is designed specifically to meet the needs of the particular turbine it supplies. These specific needs determine the volume, temperature, and pressure of steam needed to feed the turbine. For example, the modern boiler which feeds a typical 500-megawatt turbo-generator measures 185 feet in height, 35 feet by 60 feet in cross section, and weighs 7,000 tons. Because it expands when in operation and because the amount of expansion increases with age, the boiler does not stand on a foundation but must be suspended from a steel frame (based upon the manufacturer's loading specifications which establish the loads to be suspended from the overhead steel and the spacing of the steel columns needed to support the boiler and its related equipment). This determines the framework of the boiler room steel and all its platforms, stairs, and walkways. Accessory components of the boiler are also mounted on the steel frame.

The boiler structure is oriented to the turbine structure. The positioning of auxiliary equipment, layout of piping, ductwork, and electrical cables are emplaced on and supported by the same steel framework that supports the boiler.

The entire boiler and turbo-generator structure is either wholly or partially enclosed, usually with metallic skin covering, primarily to provide a facility for preheating boiler air, noise abatement, and weather protection for the equipment during operation as well as during maintenance periods. In all cases, the equipment throughout the the structure can be weatherized and in some cases where the climate is favorable it is, in fact, completely exposed to the elements (except for a covering over the generator). The actual cost of such weatherizing however, usually approximates or exceeds the cost of providing the typical sheet metal "skin type" enclosure.

Flooring is laid around the turbo-generators to provide laydown space for periodic repair and maintenance of the generating equipment. The flooring is detached and baffled from the turbo-generator pedestal to prevent vibration transfer through the structure.

Small areas within the structures are partitioned off to provide washrooms, a control room, shops, and other necessary personnel areas.

Attached to the turbine structure is an office type structure that provides the working space for plant clerical and operating personnel, such as offices, locker rooms, washrooms, etc.

Section 38 of the Internal Revenue Code of 1954 allows a credit against Federal income tax for qualified investment in "section 38 property." The determination of what property qualifies as "section 38 property" is made in accordance with the rules provided in section 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 and its structural components) but only if such property is used as an integral part of specific activities including the furnishing of electrical energy.

Section 46(c)(3) of the Code provides that in the case of section 38 property which is public utility property the amount of the qualified investment shall be 3/7 of the amount determined under section 46(c)(1) of the Code. For purposes of this section "public utility property" includes property used predominantly in the trade or business of the furnishing or sale of electrical energy.

The term "building" is defined generally and in pertinent part in section

1.48–1(e) of the Income Tax Regulations to include any structure or edifice enclosing a space within its walls the purpose of which is, for example, to provide shelter or housing, or to provide working, office, parking, display or sales space. The term includes structures such as apartment houses, factory and office buildings, warehouses, barns, garages, railway or bus stations, and stores.

This section of the regulations also provides that the term "building" does not include (i) a structure which is essentially an item of machinery or equipment, or (ii) an enclosure which is so closely combined with the machinery or equipment which it supports, houses, or serves that it must be retired, replaced, or abandoned contemporaneously with such machinery or equipment, and which is depreciated over the life of such machinery or equipment.

In the instant case and under the facts described above, the boiler and turbo-generator structure is an integrated unit of three basic pieces of machinery each interrelated to the other in terms of useful life, function, structure, and design. The spacing and location of each of the components of the unit is fixed by engineering requirements of the generating system and is not subject to rearrangement or shutdown of any of the components independently of one another. Where the structure is enclosed with a sheet metal skin, the structural elements added to support the outer covering or skin as well as such covering enclosing the structure is an integral part of the whole as described above. The enclosed areas within the boiler and turbo-generator structure do not provide "space" in the general sense in which the term applies, for example, to a factory where floor or working space is normally provided for personnel and for movement of machinery and equipment in connection with the manufacturing process or activity conducted in such factory. The nature of its design and construction of the boiler and turbo-generator structure precludes the shifting or rearrangement of the basic equipment.

Furthermore, by the nature of the specific interrelationship of the design and operation of the basic components (structure — boiler — turbine — generator) the useful economic lives of all are common to each other and it is anticipated that each component will be retired, replaced, or abandoned contemporaneously with one another. Although it is theoretically and technically feasible to replace turbines and generators, advances in technology, increases in boiler and turbo-generator efficiency and other factors make such a possibility unrealistic and if such replacement did occur it would be under rare and unusual circumstances.

Accordingly, under the facts described above, the structure enclosing the modern electric generating station is not a building under section 48 of the Code and 1.48–1(e) of the regulations. Except for the attached office structure, the entire structure qualifies as section 38 property that is "public utility property" for investment credit purposes. The service structure (offices) is a "building" and does not qualify as section 38 property for investment credit purposes.

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26 CFR 1.48–1: Definition of section 38 property.

A vessel that is documented by the U.S. Coast Guard for use in foreign and domestic commerce of the United States qualifies as section 38 property, even though it is used exclusively outside the United States.

Rev. Rul. 69–509

The taxpayer, a domestic corporation, acquired a vessel that it registered with the Commandant, United States Coast Guard, who documented it for use in foreign and domestic commerce of the United States. The vessel is used exclusively outside the United States.

Held, since the vessel is documented with the Commandant, United States Coast Guard, for use in foreign and domestic commerce of the United States, it is treated as "section 38 property" pursuant to the provisions of section 48(a)(2)(B)(iii) of the Internal Revenue Code of 1954 and, therefore, qualifies for investment credit.

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26 CFR 1.48–1: Definition of section 38 property.

Dry-kiln structures, and control rooms structures, used to remove moisture from green lumber are essentially items of machinery and equipment that qualify as section 38 property.

Rev. Rul. 69–557

Advice has been requested whether certain dry-kiln structures, described below, qualify as "section 38 property" for investment credit purposes.

A taxpayer is engaged in the business of manufacturing wood doors, porch columns, and spindles. Its principal raw material is rough cut lumber that is purchased "green" from various sawmills. "Green" lumber is newly cut "unseasoned" lumber that has the moisture content associated with the wood in its natural state. It is usually necessary, when manufacturing articles out of wood from green lumber, to remove the moisture content under controlled conditions.

In order to accomplish the moisture removing process under controlled conditions, the taxpayer uses a facility known as a "dry-kiln." Essentially, a dry-kiln facility includes a structure into which green lumber is placed, a heating system that provides the necessary temperature to draw the moisture from the lumber, and an exhaust system to remove the moisture from the enclosed structure.

The taxpayer in the instant case constructed and placed in service four dry-kiln facilities during 1968. The structure of each of these facilities has a concrete base, two sides of tile, two sides composed of large sliding doors, and a built-up roof. They are 20 feet high, 44 feet long, and 210 feet wide. The width is divided into six chambers

each 35 feet wide, sharing common walls and sealed off from one another. Each chamber contains heating coils, a spray system for steam, a sensing unit for control, fans for circulating the air, metal duct work for uniformly removing the moisture-laden hot air, and forced air venting fans. There is also a sprinkler system for fire protection.

Three control rooms were constructed on the outside of and butted against each dry-kiln structure. Each control room provides the controls for two chambers. They are constructed out of frame lumber and are six by eight feet in area and are ten feet high. The primary purpose of each control room structure is to protect the control equipment from the elements. Each control room houses the steam supply system with the shut-off valves and automatic regulating valves for controlling the steam and for adding moisture to the chamber, the control panels for the steam and heat, the controls for pressure venting, the controls for the operation of the fans, and all the main electrical panels for control of fan motors. Each dry-kiln structure includes, in combination, three control rooms and six chambers.

Each chamber contains two pressure venting systems each of which is covered by a metal movable louver that is operated by an air motor and also has a fan to force the venting action. There is a venting distribution duct that is approximately 24 inches square at the fan end and extends the length of the dry-kiln with a reduction in size continuing down its length to the other end. It has ports distributed throughout this length, for uniform air control. When the sensing devices transmit a signal to the controlling units indicating that there is too much moisture in the chamber the louvered vents open and the fans start, one bringing in the air from the outside and the other exhausting the moisture laden air from the inside. This function stops when the sensing devices send a signal to the controlling unit that the relative humidity is down to the desired level.

Inside each chamber on either side of the vertical heating coils there is a row of railroad tracks (for the rail cars) extending the length of the chamber and approximately sixty feet beyond in either direction. The floor in each chamber is sand, except for concrete ribbons that underline the tracks and provide support for the vertical coils.

A normal working load for one dry-kiln chamber is 66,500 board feet of lumber. When the dry-kilns are loaded, the doors are sealed mechanically and within three hours the temperature is raised to 190 degrees Fahrenheit and maintained for five to ten days, depending on the type of lumber desired. When the lumber is moved out, another rail car load is immediately moved in. Each dry-kiln facility is operated continuously, except for periods of breakdown and repairs.

Air space is required in the chambers for circulation of air and removal of moisture, but it would be impossible for a person to live and work anywhere within the dry-kiln structure while the facility is in operation. The dry-kiln structure is not used to provide working space or shelter. It was designed to maintain an even heat of 190 degrees Fahrenheit and to provide for an air velocity of 700 feet per minute between courses of lumber. The design is such that, during the first 24 hours, one kiln chamber will evaporate 60,000 pounds of water from green lumber. Heat, spray, and fan controls are set and then automatically controlled.

Section 38 of the Internal Revenue Code of 1954 allows a credit against Federal income tax for qualified investment in "section 38 property." Whether property qualifies as "section 38 property" is determined under the rules in section 48 of the Code and the Income Tax Regulations thereunder.

Section 1.48–1(a) of the regulations provides, in pertinent part, that property qualifying as "section 38 property" must be depreciable property having a useful life of four years or more, and must be either "tangible personal property" or "other tangible property" (except buildings or structural component of buildings) but only if used by th taxpayer as an integral part of certai specified activities.

Section 1.48–1(c) of the regulation defines "tangible personal property" t include all property in the nature o machinery (other than structural com ponents of a building or other inher ently permanent structures) eve though located outside a building.

Section 1.48–1(e)(1) of the regula tions in defining a "building" except therefrom a structure which is essen tially an item of machinery and equip ment. Brick kilns are cited in sectio 1.48–1(e)(1) of the regulations as no included in the term "building." Th structures in the instant case are com parable to the shells or chambers of a oven, or of a gas tank, and as such ar inseparable parts of (and essentiall are) items of machinery or equipmen

The dry-kiln structures in the in stant case are generally indistinguish able, except for their large size, fro the shells or chambers of ovens. N work other than automatic processes i performed within the structures. Th structures are entered by working pe sonnel only to make repairs or adjus ments to the equipment or machine housed in the structure.

Accordingly, it is held in the instan case that the taxpayer's dry-kil structures (including the control roo structures) are not "buildings" unde section 1.48–1(e)(1)(i) of the regula tions, but are essentially items c machinery or equipment qualifying a "section 38 property" for investmer credit purposes.

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26 CFR 1.48–1: Definition of section property.

"Excess" factory building cost allocated to processing machine and equipment, including their r lated systems, are not qualified i vestments in section 38 propert however, costs allocated to air-co ditioning and humidity control sy tems, including their component are qualified investments.

Rev. Rul. 69–558

Advice has been requested whether the expenditures described below are qualified investments in "section 38 property" for investment credit purposes.

The taxpayer is engaged in fabric production including the spinning of cotton yarns and the dyeing, bleaching, and finishing of fabrics in several processing plants. At some of the plants, new factory buildings were constructed; at others, the old factory buildings were modified, to take into account the installation of certain processing machinery and equipment and the installation of certain air conditioning and humidity control systems.

The new building construction included the installation of thick walls with foam glass insulation, thick roof insulation, and strong structural steel to support the machinery and equipment components of the air conditioning and humidity control systems. In converting the older buildings, the windows were removed and the openings blocked with a sandwich-type siding with insulation between outer and inner sidings. Additional wall and roof insulation and structural steel were added. In some of the factory buildings, the floors were heavily reinforced to accommodate the use of heavy processing machinery and equipment and to permit multiple utilization of smaller processing machines and equipment. Electrical, steam, and water services were installed to serve the factory buildings and the operating machinery and equipment contained therein.

The taxpayer allocated portions of the costs of the thick walls and roofs (including insulation), the structural steel, the removal and blocking of the windows, and the reinforced factory floors to costs for the processing machinery and equipment and to costs for the components (machinery) of the air conditioning and humidity control systems. The taxpayer considered the portions of the allocated costs (i.e. those allocated to the costs of machinery and equipment) as being in excess of the costs of such items for a so-called "normal" factory building. Thus, the question is whether these "excess factory building costs" are for machinery and equipment that qualifies as "other tangible property" that are qualified investments in "section 38 property," or are costs for nonqualifying "buildings" (or "structural components" of "buildings").

During 1968, the factory buildings and modifications were completed. The electrical, steam, and water services, the air conditioning and humidity control systems, and the processing machinery and equipment were installed in all the buildings.

The air conditioning and humidity control systems include the following components: special air handling units; control systems; duct work; motors, pumps, chillers, and water tanks; and compressors. Each of the components (machinery) of the air conditioning and humidity control systems, the processing machinery and equipment, and the electrical, steam, and water service facilities are depreciable property and have a useful life of four years or more.

These air conditioning and humidity control systems are necessary to maintain the temperature and humidity within narrow optimum ranges that are essential to the processing of the taxpayer's products. It has been established that the system provide only incidentally for the comfort of employees or serve areas where such temperature or humidity requirements are not essential.

The newly constructed factory buildings and the old factory buildings, both before and after modification, were factually determined to be "buildings" as defined under section 1.48–1(e)(1) of the Income Tax Regulations.

Section 38 of the Internal Revenue Code of 1954 allows a credit against Federal income tax for qualified investment in "section 38 property." The determination of what property qualifies as "section 38 property" is made in accordance with the rules provided in section 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 buildings and their structural components) if such other property is used as an integral part of certain specified activities (including processing and manufacturing). In order to qualify as "section 38 property," the property must also be depreciable property and have a useful life of four years or more.

Section 1.48–1(c) of the regulations provides, in pertinent part, that "tangible personal property" means any tangible property except land and improvements thereto, such as buildings or other inherently permanent structures (including items that are structural components) that is contained in or attached to a building, including production machinery. Further, all property that is in the nature of machinery (other than structural components of buildings or other inherently permanent structures) is considered "tangible personal property" even though located outside a building. "Tangible personal property" may qualify as "section 38 property" irrespective of whether it is used as an integral part of any of the specified activities.

Section 1.48–1(e)(1) of the regulations defines the term "building" to mean 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 terms does not include a structure that is essentially an item of machinery or equipment.

Section 1.48–1(e)(2) of the regulations states, in pertinent part, that the term "structural components" includes such parts of a building as walls, partitions, floors and ceilings, as well as any permanent coverings therefor such as paneling or tiling; windows or doors; all components (whether in, on, or adjacent to the building) of a central

air conditioning or heating system, including motors, compressors, pipes and ducts; plumbing and plumbing fixtures, such as sinks and bathtubs; electric wiring, and lighting fixtures, chimneys; stairs, escalators, and elevators, including all components thereof; sprinkler systems; fire escapes; and other components relating to the operation or maintenance of a building. However, the term "structural components" does not include machinery the sole justification for the installation of which is the fact that such machinery is required to meet temperature or humidity requirements that are essential for the operation of other machinery or the processing of materials or foodstuffs (the so-called "justification" test). Machinery may meet the sole justification test even though it incidentally provides for the comfort of employees, or serves, to an insubstantial degree, areas where such temperature or humidity requirements are not essential. For example, an air conditioning and humidification system installed in a textile plant in order to maintain the temperature or humidity within a narrow optimum range which is critical in processing particular types of yarn or cloth is not included within the term "structural components."

It is held that the walls (including the insulation, and the removal and blocking of the windows), the roofs (including the insulation), and the reinforced floors, in the instant case, are "structural components of buildings," within the meaning of section 1.48–1(e)(2) of the regulations. Therefore, the costs of these "structural components of buildings" including the portions referred to as "excess factory building costs" are not qualified investments in "section 38 property" for investment credit purposes.

However, the special air handling units, control systems, duct work, motors, pumps, chillers, and water tanks, and compressors are all components (machinery) of the air conditioning and humidity control systems installed in the taxpayer's buildings to maintain necessary temperature and humidity levels, essential for processing materials, and meet the requirements of the "sole justification" test described in section 1.48–1(e)(2) of the regulations. Therefore, the air conditioning and humidity control systems, including the above components, are "tangible personal property" within the meaning of section 1.48–1(c) of the regulations, the costs of which are qualified investments in "section 38 property" for investment credit purposes.

Furthermore, in the instant case, the electrical, steam, and water service systems installed in and through each of the taxpayer's factory buildings that serve both for normal operation and maintenance of the buildings, and for the operation of machinery and equipment contained therein, are "structural components" of "buildings" within the meaning of section 1.48–1(e)(2) of the regulations and the costs thereof are not qualified investments in "section 38 property" for investment credit purposes.

However, the electrical wiring and special outlets (buss ducts), the secondary steam lines (which are tap-offs from the main steam lines), the water lines, and pipe insulation, leading directly to, within, and interconnecting with special items of processing machinery or equipment are not parts of the electrical, steam, and water service systems (the "structural components" referred to above), but are parts of the particular items of processing machinery or equipment to which they directly lead, are within, or interconnect. Therefore, their costs, as part of the costs for such items of machinery or equipment, are qualifying investments in "section 38 property" for investment credit purposes. Compare Revenue Ruling 66–299, C.B. 1966–2, 14, which considers whether certain mechanical service systems (plumbing, electrical, and sprinkler systems) of factory building structures qualify as "section 38 property" for investment credit purposes.

26 CFR 1.48–1: Definition of section property.

Leased propane gas stora tanks, water heaters, and wa softeners, separately installed a maintained on customers' proper qualify as "section 38 propert for investment credit.

Rev. Rul. 69–602

Advice has been requested wheth under the circumstances described l low, certain propane gas storage ta and other equipment rented to a t payer's customers are "section 38 pr erty" for investment credit purpos

The taxpayer is engaged in the bu ness of selling propane gas at retail. its business of purchasing and selli this gas the taxpayer uses four differe types of storage tanks. They are bu storage tanks, large storage tanks f industrial users, small storage tanks f personal residences or small business and tanks mounted on trucks to tra port the gas. All of these tanks are c indrical metal storage tanks of sin units varying in capacity from 1 gallons to 30,000 gallons.

The bulk storage tanks and the la tanks for commercial users vary capacity from 7,000 to 30,000 gallo When in use they are mounted on shaped concrete supports molded to the particular tank involved. T smaller tanks used for personal re dences and small businesses have tached brackets and are placed pads. They vary in capacity from 1 to 1,000 gallons; most are 500 gall in size.

The bulk storage tanks are used store the gas prior to sale to custome The other tanks (except the tru mounted ones) are rented to c tomers. These tanks are manufactu as single units, they are trucked to location where they are to be used a are placed on their supports. The ta can be moved to a different location simply lifting them off the supports a transporting them to a new locati In one year there were over 8,100 stallations and 4,400 removals of ta for the service area of the taxpayer

When requested by the customer, the taxpayer also furnishes on a rental basis water heaters and water softeners for the use of its customers. They are removed from service at the same time as the gas storage facilities are removed from service and, consequently, are not ordinarily used over their estimated useful lives by a single customer.

All items involved here are depreciable property and have a useful life of four years or more.

Section 38 of the Internal Revenue Code of 1954 allows a credit against Federal income tax for qualified investment in "section 38 property." The determination of what items of property qualify as "section 38 property" is made in accordance with the rules provided under section 48 of the Code.

Sections 1.48–1 (a) and (d) of the Income Tax Regulations provide, in part, that the term "section 38 property" means depreciable property having an estimated useful life of four years or more when placed in service which is either "tangible personal property" or "other tangible property" (not including structural components of a building) but only if such other property is used as an integral part of certain specified activities, including the furnishing of gas services to customers by a person engaged in the business of furnishing such services, or is a "storage facility" used in connection with providing gas services.

Section 1.48–1(c) of the regulations defines "tangible personal property" as any tangible property except land and improvements thereto, such as buildings or other inherently permanent structures (including items which are structural components of such buildings or structures).

Under section 1.48–1(e)(2) of the regulations, "structural components" of a building include a heating system, plumbing, and plumbing fixtures, relating to the operation or maintenance of a building.

Gas storage tanks installed and used as a part of the heating and plumbing system are normally classified as "structural components" of the building containing the related equipment that utilizes the propane gas, even though placed outside the building. However, in this case the taxpayer, by its installation, maintenance, and control practices, retained ownership of its rental tanks, separate and apart from the buildings. Therefore, the installation of a tank as a structural component of a building is not present, as in the case of tanks normally installed as a part of the heating and plumbing system of a building. This fact is further substantiated by the established number of installations and removals. The water heaters and water softeners are also installed, maintained, and controlled separately from the plumbing components of the customer's building.

Accordingly, in this case, the taxpayer's propane gas storage tanks, water heaters, and water softeners installed and rented to its customers as described above are tangible personal property and, therefore, qualify as "section 38 property" for investment credit purposes.

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26 CFR 1.48–1: Definition of section 38 property.
(Also Section 46; 1.46–2.)

A mutual casualty insurance company, taxed solely on investment income in 1962, is not entitled to investment credit and carryover of unused credit on certain property acquired and used in 1962; no special limitations apply to carrybacks of unused credit to 1962.

Rev. Rul. 69–603

Advice has been requested whether a mutual casualty insurance company is entitled to investment credit for that portion of tangible personal property acquired during 1962 for which a deduction for depreciation was not allowable, and if not, whether such credit may be carried forward to subsequent taxable years. Advice has also been requested whether an unused investment credit in 1963–1965, inclusive, may be carried back to the taxable year 1962.

The taxpayer is a mutual casualty insurance company that is taxable under section 821 of the Internal Revenue Code of 1954. For the year 1962 the taxpayer was taxed solely on its investment income (since such tax was greater than the tax computed on the alternative basis of one percent of certain items of gross income). As a result of the Revenue Act of 1962, the taxpayer has been subject to tax on its overall operations for its taxable year 1963 and subsequent years.

In 1962 the taxpayer purchased and placed in service certain tangible personal property for use in both its underwriting operations and its investment department. The taxpayer incurred net operating losses in each of the years 1963, 1964, and 1965. The investment credit determined in those loss years exceeded the limitation provided by section 46(a)(2) of the Code (relating to "Limitation based on amount of tax").

Section 38 of the Code provides that there shall be allowed as a credit against tax the amount determined in sections 46, 47, and 48 of the Code.

Section 48(a)(1) of the Code defines "section 38 property," in part, as tangible personal property with respect to which depreciation is allowable.

Section 1.48–1(b)(2) of the Income Tax Regulations states, in part, that if depreciation is allowable only with respect to a part of property placed in service, only the proportionate part of the property with respect to which depreciation is allowable qualifies as "section 38 property" for purpose of determining the amount of credit allowable under section 38 of the Code.

Section 46(b) of the Code provides, in pertinent part, that if the amount of investment credit for any taxable year exceeds the limitation on the credit for such taxable year, the excess credit shall be (A) an investment credit carryback to each of the three taxable years preceding the unused credit year (but only to taxable years ending after December 31, 1961), and (B) an investment credit carryover to each of

the seven taxable years following the unused credit year.

Section 1.48–1(a) of the regulations provides, in part, that the determination of whether property qualifies as "section 38 property" in the hands of the taxpayer for purposes of the credit allowed by section 38 must be made with respect *to the first taxable year in which such property is placed in service by the taxpayer.*

Since the taxpayer was subject to tax only on its investment income in the taxable year 1962, depreciation was allowable only on the proportionate part of the tangible personal property purchased in such year that was utilized in its investment department. See section 1.48–1(b)(2) of the regulations.

It is held that the taxpayer is entitled to the investment credit on only the proportionate part of property acquired during 1962 for which depreciation was allowable. It is also held that, since the determination of whether the personal property purchased and placed in service in 1962 qualifies as "section 38 property" for purposes of investment credit must be made in that year, there is (and can be) no unused credit with respect to the proportionate part of such property that is allocable to the underwriting operations.

With respect to the question whether the unused investment credit determined in 1963, 1964, and 1965, may be carried back to 1962, section 46(b) of the Code provides for the carryback and carryover of unused credits. Although this section contains certain limitations as to the years to which an unused credit may be carried and limitations as to the dollar amount of an unused credit which may be carried to a particular year, there are no special limitations upon the carryback of an unused credit by a mutual casualty insurance company.

Accordingly, it is further held that the taxpayer may carryback unused credits from its taxable years 1963, 1964, and 1965, to its taxable year 1962 subject to the provisions of section 46(b) of the Code and the regulations thereunder.

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26 CFR 1.48–1: Definition of section 38 property.

Moveable glass windows enclosing a race track grandstand and related mechanical equipment for raising and lowering the windows do not qualify as "section 38 property"; the window washing equipment qualifies.

Rev. Rul. 69–614

Advice has been requested whether moveable glass windows enclosing a race track grandstand and their related mechanical equipment qualify as "section 38 property" for the investment credit.

The taxpayer is engaged in the business of operating a race track licensed under state laws. The race track has been in operation for several years with an open or exposed front grandstand. The property in question completely encloses the front portion of the grandstand and consists of vertical sliding tempered glass windows (lowered from the top and raised from the bottom by a series of electric powered cables and pulleys), and window washing equipment.

Section 38 of the Internal Revenue Code of 1954 allows a credit against Federal income tax for qualified investment in "section 38 property." The determination of what items of property qualify as "section 38 property" is made in accordance with section 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 buildings and their structural components) if such other property is used as an integral part of certain specified activities (including manufacturing, production, or extraction). In order to qualify as "section 38 property," the property must also be depreciable property and have a useful life of four years or more.

Section 1.48–1(c) of the Income Tax Regulations provides, in pertinent part, that "tangible personal property" means any tangible property except land and improvements thereto, such as buildings or other inherently permanent structures (including items that are structural components of such buildings or structures). Further, all property which is in the nature of machinery (other than structural components of a building or other inherently permanent structure) shall be considered tangible personal property even though located outside a building.

Section 1.48–1(e)(1) of the regulations states, in pertinent part, that buildings and structural components thereof do not qualify as section 38 property. 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 to provide shelter, or housing, or to provide working space, parking, display, or sales space. Section 1.48–1(e)(2) of the regulations provides in pertinent part that such part of a building as walls, partitions, floors and ceilings, windows and doors, and other components relating to the operation or maintenance of a building, are structural components of the building.

The grandstand is a building that provides spectator shelter and space within its walls for the viewing of race track events. The glass windows form the fourth side of the grandstand.

The machinery and equipment, cables and pulleys to operate the windows, and the electrical system to operate the equipment are necessary to the proper functioning of the window and are component parts thereof.

The window washing equipment is not a component part of the machinery and equipment necessary to operate the windows, nor is it a structural component of the building. Therefore, the window washing equipment is "tangible personal property."

Accordingly, it is held that the vertical sliding glass windows, together with their machinery and equipment

including the electrical system necessary for their operation, do not qualify as "section 38 property" for investment credit purposes. However, the window washing equipment does qualify since it is tangible personal property.

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 162; 1.162–1.)

Compensation paid by a corporation to "Owners," with respect to cash and securities subject to a "Subordination Agreement," is ordinary income to the owners and is deductible by the corporation as ordinary and necessary business expenses.

Rev. Rul. 69–455

Advice has been requested concerning the Federal income tax treatment of the transaction described below.

In order to comply with the rules and regulations relating to capital requirements of the New York Stock Exchange (Rule 325, New York Stock Exchange Rules) of which the corporation is a member, certain individuals (Owners) executed "Subordination Agreements" with respect to their brokerage accounts with the corporation.

Rule 325 provides that the ratio of "Aggregate indebtedness" of a member firm to its "Net Capital" may not at any time exceed 20 to 1. For purposes of Rule 325, the "Subordination Agreements" will be recognized in computing "Net Capital" and will not be recognized in computing "Aggregate indebtedness." "Net Capital," as computed under Rule 325, is designed to reveal the minimum amount that would, under normal circumstances, be readily realizable by a member firm for the claims of customers and general creditors.

Under the terms of the "Subordination Agreements," securities and cash on deposit in the "Owners" accounts with the corporation are subordinated to the claims of present and future creditors of the corporation. However, the corporation has the right to liquidate the securities or to pledge them as collateral only if an "event of financial restriction" occurs (e.g., insolvency or bankruptcy of the corporation, or a determination by the corporation that the securities are needed to meet the capital requirements of the Exchange). Prior to the occurrence of an "event of financial restriction," the "Owners" will remain the legal and beneficial owners of the securities and all dividends and interest from the securities will be paid to them. They will have the benefit of any increase and bear the risk of any decrease in the value of the securities, and have the sole right to vote with regard to the securities. The "Owners" may also buy, sell, exchange, and substitute securities in their accounts, and, in certain circumstances, withdraw securities from their accounts. If an "event of financial restriction" occurs and the securities are liquidated, the "Owners" will have a subordinated claim against the corporation in an amount equal to the amount realized by the corporation upon their liquidation. On specified dates, the corporation will pay to the "Owners" a reasonable rate of compensation with regard to the cash and securities subject to the "Subordination Agreement."

In view of the foregoing, the securities subject to the "Subordination Agreements" prior to the occurrence of an "event of financial restriction" are the property of the "Owners" and any income derived from the securities is income of the "Owners" and not income of the corporation.

The compensation paid by the corporation to the Owners with respect to the cash and securities subject to the "Subordination Agreements" represents a charge for making such securities and cash available on a standby basis for use by the corporation upon the occurrence of an "event of financial restriction," and as such it is similar to a "commitment fee" discussed in Revenue Ruling 54–43, C.B. 1954–1, 119, which holds that such fees are deductible as ordinary and necessary business expenses under section 23(a)(1) of the Internal Revenue Code of 1939 (section 162 of the Internal Revenue Code of 1954).

Accordingly, the compensation paid by the corporation to the "Owners" with respect to the cash and securities subject to the "Subordination Agreements" is deductible by the corporation as an ordinary and necessary business expense under section 162 of the Code. Further, compensation received by the "Owners" for the use of the securities by the corporation is ordinary income of the "Owners."

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26 CFR 1.61–1: Gross income.
(Also Section 451; 1.451–1.)

Commissions in excess of rates established by a government agency that are required to be deposited with the court while the rates are being contested are not reported in gross income until the taxable year ownership has been judicially determined; O.D. 980 superseded.

Rev. Rul. 69–642 [1]

The taxpayer, a domestic corporation, collected commissions from its customers in excess of the schedule of commissions sought to be established by a government agency. In the same year the taxpayer objected to the low rate of commission to be imposed by the agency and filed for and received a restraining order from the court enjoining the putting into effect of the commission schedule until a final determination of the case. The court order required that the taxpayer deposit with the clerk of the court the portion of the commissions collected by it that was in excess of the commission specified in the agency's schedule. Upon final determination of the suit instituted by the taxpayer the clerk of the court will refund the deposit to the taxpayer or to the taxpayer's customers

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

from whom the commissions were collected.

Held, the commissions so deposited by the taxpayer are not to be reported as gross income until the taxable year in which the ownership therein has been judicially determined.

O.D. 980, C.B. 5, 97 (1921), is hereby superseded, since the position stated therein is set forth under the current statute and regulations in this Revenue Ruling.

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26 CFR 1.61–1: Gross income.
(Also Section 1221; 1.1221–1.)

Money received in consideration of an agreement not to compete is ordinary income in year of receipt; O.D. 668 superseded.

Rev. Rul. 69–643 [1]

M, a domestic corporation, sold its plant, equipment, trade name, and good will to *O* an unrelated domestic corporation. One of the conditions of the sale was an agreement by *M's* president, *A,* that he would not engage in a similar business in a stipulated area. *A* received money from *O* with respect to the above agreement.

Held, the amount received by *A* in consideration of his agreement not to compete is ordinary income to him in the year of receipt.

O.D. 668, C.B. 3, 93 (1920), is hereby superseded, since the position stated therein is set forth under the current statute and regulations in this Revenue Ruling.

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26 CFR 1.61–1: Gross income.

Premiums on a group insurance policy that would reimburse officers of a corporation for their expenses arising from their wrongful acts. See Rev. Rul. 69–491 page 22.

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26 CFR 1.61–1: Gross income.

Whether depositors report as income the tax assessed by the State of Rhode Island on their deposits where the national banks have elected to pay such tax. See Rev. Rul. 69–497, page 23.

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26 CFR 1.61–1: Gross income.

Payments made by an apprenticeship educational and training trust fund to pre-apprenticeship and apprenticeship training program students. See Rev. Rul. 69–519, page 185.

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

Treatment of stock of a corporation contributed to the corporation by a shareholder and distributed by the company to its employees. See Rev. Rul. 69–368, page 27.

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

Cash discounts on merchandise purchased. See Rev. Rul. 69–619, page 111.

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

Whether advances on commission, where there is an unconditional personal obligation to repay the advances, constitutes income in the year received. See Rev. Rul. 69–465, page 27.

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

Whether gain realized upon the retirement by a corporation of its own bonds may be considered to be gain from a sale or exchange. See Rev. Rul. 69–613, page 163.

Part II. Items Specifically Included in Gross Income

Section 71.—Alimony and Separate Maintenance Payments

26 CFR 1.71–1: Alimony and separate maintenance payments; income to wife or former wife.

A husband's monthly payments to his wife, pursuant to a community property settlement agreement under a divorce decree for relinquishing her rights in his retirement pay, are not deductible alimony payments but are includible in the wife's income.

Rev. Rul. 69–471

Advice has been requested whether certain payments made in accordance with the terms of a community property settlement agreement are in the nature of alimony payments within the meaning of section 71 of the Internal Revenue Code of 1954.

The taxpayer wife obtained a divorce in Texas, a community property State, where she and her husband were domiciled during their marriage. A community property settlement agreement was incorporated in the divorce decree. At the time of the divorce, the taxpayer's husband, an officer of the Armed Forces, lacked approximately three months of active service to become eligible for the retirement benefit based on twenty years of active military service. The property settlement stated that entitlement to the retirement pay was community property; that the retirement pay would be 30*x* dollars per month; and that the taxpayer was entitled to one-half of such pay, 15*x* per month. The agreement further provided that the taxpayer relinquished her rights in the first sixty-nine payments of the retirement pay in exchange for her husband's promise to pay her 30*x* dollars per month for thirty-six months.

Since the Federal laws providing for the payment of Armed Forces retirement benefits for age or length of service do not preclude such benefits being divided as community property for Federal income tax purposes, the determination whether the benefits are separate or community property in a specific situation is governed by State law. See *Burns Poe* v. *H. G. Seaborn,* 282 U.S. 101 (1930), Ct.D. 259, C.B. IX–2, 202 (1930).

The character of property as community or as separate is determined under Texas law at the time it is acquired, and the word "acquired" is interpreted as contemplating the inception of title to property. *J. P. King* v.

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

Homer L. Bruce, 197 S.W. (2d) 830 (1946) Compensation for services performed as an employee has its inception in the performance of services. *C. J. Wrightsman* v. *Commissioner,* 40 B.T.A. 502 (1939), affirmed, 111 Fed. (2d) 227 (1940).

Revenue Ruling 63–169, C.B. 1963–2, 14, holds that retirement pay of a member of the Armed Forces is additional compensation for past services. Considering that a wife under Texas law has a present vested one-half interest in the community which includes the husband's compensation (*Rompel* v. *United States,* 59 Fed. Supp. 483 (1945), reversed on other grounds, 326 U.S. 367 (1945)), she would also have an equal right in payments made as additional compensation for past services.

Since the payments the wife is entitled to receive as retirement benefits are actually from her share of the community property, any question of the payments being alimony is foreclosed by section 1.71–1(c)(4) of the Income Tax Regulations which specifically states that "Section 71(a)(1) or (2) does not apply to that part of any periodic payment attributable to that portion of any interest in property * * * which interest originally belonged to the wife." See *Howard S. Dudley,* 39 B.T.A. 1170 (1939).

The transfer by the wife of her interest in the first sixty-nine monthly retirement benefit payments was a sale of her rights to such payments. Because the interest transferred was a right to future income, it was an assignment of income under the rule of *Commissioner* v. *P. G. Lake, Inc.,* et al., 356 U.S. 260 (1958), Ct.D. 1823, C.B. 1958–1, 516.

Accordingly, the thirty-six monthly payments of 30*x* dollars the husband pays in accordance with the terms of the community property settlement agreement are includible in the wife's gross income as ordinary income in the years received.

Section 72.—Annuities: Certain Proceeds of Endowment and Life Insurance Contracts

26 CFR 1.72–16: Life insurance contracts purchased under qualified employee plans. (Also Section 402; 1.402(a)–1.)

An employee who participated for only one month in an employees' plan that provides life insurance must include in gross income the annual term cost reduced by the unearned premium credit reallocated to pay premiums for remaining employee-participants.

Rev. Rul. 69–490

Advice has been requested as to the extent the annual net term cost of life insurance provided by a group retirement income contract is taxable under section 72 of the Internal Revenue Code of 1954, to an employee-participant in a qualified plan under the circumstances described below.

An employer established and maintains a pension plan that meets the requirements of section 401 of the Code and is funded by a group retirement income contract that provides incidental life insurance protection on the life of each employee-participant. Under the terms of the contract, if an employee terminates his employment before the end of the twelve month period covered by the annual premium, his life insurance protection ceases and the unearned portion of the premium is credited to the trust by the insurance company and applied to pay subsequent insurance premiums.

An employee became a participant on the same date the annual premiums were paid and was provided life insurance protection for one year beginning on that date. One month later he terminated his employment, resulting in termination of the life insurance protection on his life and a credit to the trust of the unearned premium for such insurance. The question arises whether the terminated employee is taxable on the net term cost of life insurance for the entire contract year or for only the one month he was afforded such protection.

Section 402(a)(1) of the Code and section 1.402(a)–1(a) of the Income Tax Regulations provide that the amount actually distributed or made available to any distributee by an exempt employees' trust shall be taxable to him, in the year in which so distributed or made available, under section 72 (relating to annuities).

Section 72(m)(3) of the Code provides that any employer contribution to a qualified trust and any income from such trust that has been applied to purchase life insurance protection, where the proceeds of such contract are payable directly or indirectly to a participant in such a trust or to a beneficiary of such participant, is includible in the gross income of the participant in the taxable year when so applied.

The net term cost of current life insurance protection purchased with employer contributions to, or income from, a qualified trust is includible in the employee's gross income for the year or years such protection is provided because such use of trust funds results in a distribution from the trust. Rev. Rul. 56–634, C.B. 1956–2, 291.

Where such cost is on a full year basis and the contract does not provide for a premium refund or credit, the employee is taxable on the net term premium cost of insurance on his life for the entire year. However, in this case, there is a provision for a credit to be applied against subsequent premiums to be paid by the employer. Thus, the otherwise taxable distribution is thereby reduced by the amount of such credit. The application of the credit to subsequent premiums constitutes taxable income, to the extent of the net term cost, to the employees then benefiting from the insurance protection.

It is held that, under section 72 of the Code, the terminated employee is to include in taxable income the annual term cost of the life insurance protection provided him, reduced by the amount of the credit.

26 CFR 1.72–16: Life insurance contracts purchased under qualified employee plans. (Also Section 402; 1.402(a)–1.)

The cost of current life insurance protection provided by an exempt employees' trust to an employee-participant is includible in his gross income in the year paid even though his interest in the insurance contract may be forfeited prior to his death.

Rev. Rul. 69–544

Advice has been requested whether amounts applied by an exempt employees' trust for current life insurance protection provided under a qualified plan are includible in the gross income of the plan participants under the circumstances described below.

An employer established an employees' pension plan that qualified under section 401(a) of the Internal Revenue Code of 1954 and a related trust that was exempt under section 501(a). All contributions are paid by the employer.

The plan provides for the purchase of incidental life insurance protection for insurable participants. The trustee is required to purchase life insurance policies, to hold these policies for the participants, and to pay the premiums thereon out of trust funds. The policies provide for the payment of the death benefits to the beneficiaries of the insured participants if the participants die while they are employed. Under the plan, the participants are given the power to designate their beneficiaries.

The plan also provides that a participant shall forfeit his interest under the plan if his employment is terminated as a result of his dishonesty, fraud, gross neglect of duty, or intentional damage to the employer's property. In the event of such a forfeiture, and only in that event, any insurance contract held for the participant becomes the trustee's property and the trustee is then empowered to rescind the participant's designation of a beneficiary by cancellation of the policy and to receive the cash surrender value thereunder, if any. However, this power may not be exercised after the death of the participant.

Section 402(a) of the Code provides that the amount actually distributed or made available to a distributee by an exempt trust shall be taxable to him, under section 72, in the year in which so distributed or made available.

Section 72(m)(3) of the Code and section 1.72–16(b)(2) of the Income Tax Regulations provide that any deductible contribution to an employees' trust and any income from such a trust that is applied to purchase life insurance protection is includible in the gross income of the participant in the taxable year when so applied, where the proceeds of the life insurance contract are payable, directly or indirectly, to the participant or his beneficiary. However, section 1.72–16(b)(6) of the regulations provides that the above requirement shall not apply if the trust has a right under any circumstances to retain any part of the proceeds of the life insurance payable to the named beneficiary.

So long as a participant in this case remains in the employ of the employer he is entitled to have trust funds applied to provide life insurance protection. If he dies while in the employ of the employer, his beneficiary will be entitled to receive the proceeds of the policy and the trustee will have no right to any of the life insurance proceeds paid by reason of the participant's death. As used in section 1.72–16(b)(6) of the regulations, the trust's right to retain any part of the proceeds of the life insurance under the contract means a present right as a named beneficiary to receive the life insurance proceeds. In this case the trust does not have a present right as a named beneficiary to receive the proceeds of the contract and there is no basis for overriding the specific provisions of section 72(m)(3) of the Code.

Accordingly, it is held that the amounts applied by the trustee to pay the cost of current life insurance protection provided under this plan are includible in the gross income of the participants in the year paid.

Section 74.—Prizes and Awards

26 CFR 1.74–1: Prizes and awards.

Whether an automobile won by a taxpayer is includible in gross income to the extent of its fair market value. See Rev. Rul. 69–510, page 23.

Section 79.—Group-Term Life Insurance Purchased for Employees

26 CFR 1.79–1: General rules relating to group-term life insurance purchased for employees.

In determining the exclusion for the cost of group-term life insurance purchased for employees, the term "applicable jurisdiction" in section 1.79–1(b)(1)(i) of the regulations means the State whose laws govern the terms and conditions of the policies.

Rev. Rul. 69–423

Advice has been requested as to the maximum amount of term-life insurance protection that can be provided under a plan of group-term life insurance, the cost of which would be excludable from the gross incomes of the insured employees by virtue of section 79 of the Internal Revenue Code of 1954, under the circumstances described below.

The taxpayer was incorporated under the laws of State Y but its principal place of business is in State Z. The taxpayer has a plan of group-term life insurance that is incorporated into a written document under which term life insurance coverage up to a maximum amount of $40,000 is provided for all of its employees including salesmen who work in various states.

The group-term life insurance policy was purchased from, and was issued and delivered by a company licensed to do business in State Z where the taxpayer has its principal place of business. The terms and conditions of the policy are governed by the laws and regulations of that State. Under such laws and regulations the maximum

amount of protection that can be provided by an employer for employees under a master policy providing only group-term life insurance protection is $40,000. Under the laws and regulations of State *Y*, where the taxpayer was incorporated, the maximum amount of protection that can be provided under such a policy is $30,000.

Section 79 of the Code provides the general rule that there shall be included in the gross income of an employee for the taxable year an amount equal to the cost of group-term life insurance on his life provided for part or all of such year under a policy (or policies) carried directly or indirectly by his employer (or employers); but only to the extent that such cost exceeds the sum of (1) the cost of $50,000 of such insurance and (2) the amount (if any) paid by the employee toward the purchase of such insurance.

Section 1.79–1(b)(1)(i) of the Income Tax Regulations defines group-term life insurance and provides, in part, that group-term life insurance is term life insurance protection provided under a master policy, or group of individual policies, which policy or policies constitute life insurance contracts for the purpose of section 101(a) of the Code and form a part of a plan of group insurance as defined in section 1.79–1(b)(1)(iii) of the regulations. Section 79 of the Code only applies to insurance that provides general death benefits. Section 79 does not apply to any amount of life insurance protection provided for an employee by an employer that is in excess of the maximum amount of such protection that could, under the law of the applicable jurisdiction, be provided by such employer for such employee under a master policy providing only group-term life insurance protection.

The term "applicable jurisdiction" as used in section 1.79–1(b)(1)(i) of the regulations means the State whose laws govern the terms and conditions of the policies. Accordingly, it is held that, under the instant taxpayer's plan of group-term life insurance, the cost of coverage not in excess of $40,000 is not includible in the gross income of the insured employees.

Part III. Items Specifically Excluded From Gross Income

Section 111.—Recovery of Bad Debts, Prior Taxes, and Delinquency Amounts

26 CFR 1.111–1: Recovery of certain items previously deducted or credited.

Recovery of contested taxes previously paid and deducted in determining undistributed personal holding company income. See Rev. Rul. 69–620, page 137.

Section 117.—Scholarships and Fellowship Grants

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

A fellowship grant based on an application in which travel expenses were itemized satisfies the requirements of section 1.117–1(b)(2)(i) of the regulations.

Rev. Rul. 69–367

The taxpayer applied for and received a fellowship grant that qualified as a fellowship excludable from his gross income under section 117 of the Internal Revenue Code of 1954 subject to the limitation of section 117(b)(2)(B) of the Code concerning individuals who are not candidates for degrees.

At the time the taxpayer applied for the grant he submitted as a part of his application a proposed budget enumerating all of his anticipated expenditures, including a list of estimated travel expenses that would be incident to his studies. The amount of the grant subsequently paid to the taxpayer was equal to that requested by him in his application, but no part of the grant was itemized to indicate what portion was intended to cover travel expenses. However, the letter from the grantor informing the taxpayer that he had been awarded the fellowship stated that the grant was for study and travel.

Held, the requirement in section 1.117–1(b)(2)(i) of the Income Tax Regulations that the amount received by the individual be specifically designated to cover expenses for travel is considered satisfied in the instant case, since it is established that the amounts to cover the expenses for travel were itemized in the application for the fellowship, the amount of the grant was based upon such itemization, and was stated to be for both study and travel. Thus the amounts received by the taxpayer to cover travel expenses are excludable under section 117(a)(2) of the Code to the extent that the amounts are so expended by him.

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

Amounts received from an exempt educational fund as a "leadership fellows award" to train school officials in economically disadvantaged rural counties are excludable under section 117 of the Code.

Rev. Rul. 69–472

Advice has been requested whether, under the circumstances described below, all or part of a "leadership fellows award" made to a taxpayer is excludable from his gross under the provisions of section 117(a) of the Internal Revenue Code of 1954.

A fund, exempt from Federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3) thereof, established a leadership development program for the advancement of education. Fellowships granted under the program are for the specific purpose of providing educational leadership training for school officials in economically disadvantaged rural counties.

When the award was made to the taxpayer he was the principal of a rural county school and he was given administrative leave from his position to accept the grant. Under the terms of the fellowship agreement the fund paid the fellowship award to the taxpayer's school board for disbursement to the taxpayer in monthly installments over the period of the award. This arrangement did not in any way constitute an employment agreement between the recipient and the

school. None of the parties (the taxpayer, the school board, or the fund) considered this disbursing function by the school board to be, directly or indirectly, a required part of the fellowship agreement or a term of employment. The taxpayer's activities during the period of the grant consisted of study, research, and observation of innovative programs already in operation, with a view toward implementing these programs in a rural school environment. The taxpayer was not a candidate for a degree nor was the training required of the taxpayer in order to continue his employment.

Section 61 of the Code provides, in part, that gross income means all income from whatever source derived including compensation for services.

Subject to certain limitations and qualifications, section 117(a) of the Code provides that gross income of an individual does not include any amount received as a scholarship at an educational institution or as a fellowship grant.

Section 117(b)(2) of the Code provides, in part, that the limitation on the amount of a scholarship or fellowship grant that may be excluded from the gross income of an individual who is not a candidate for a degree is $300 a month for a period (whether or not consecutive) not to exceed 36 months. This section requires, in the case of an individual who is not a candidate for a degree, that the grantor be one of a number of designated organizations, including specifically an organization described in section 501(c)(3) of the Code that is exempt from tax under section 501(a) of the Code.

Whether an amount received by an individual is excludable from his gross income under section 117 of the Code depends upon the facts and circumstances under which the payment is made. The exclusion provision applies only to scholarship or fellowship grants. A scholarship or fellowship grant is an amount paid or allowed to an individual for the primary purpose of furthering the education and training of the recipient in his individual capacity.

Section 1.117–4(c) of the Income Tax Regulations provides, in part, that any amount paid or allowed to or on behalf of an individual to enable him to pursue studies or research shall not be considered to be an amount received as a scholarship or fellowship grant if the amount represents compensation for past, present, or future employment services, if the amount represents payment for services that are subject to the direction or supervision of the grantor, or if the research or studies are for the benefit of the grantor. Any of these conditions will negate the existence of a scholarship or fellowship grant as defined in the regulations.

The facts in the instant case indicate that the primary purpose of the grant to the taxpayer was to aid him in his education and training and not to compensate him for past, present, or future employment services.

Accordingly, it is held that the amounts received by the taxpayer from the fund as a leadership fellows award are amounts received as a scholarship or fellowship grant and are excludable from his gross income under section 117 of the Code, subject to the limitations of section 117(b)(2) of the Code.

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26 CFR 1.117–3: Definitions.

Amounts paid by a city health department to trainees in the department's alcoholism counselor training program are excludable fellowship grants.

Rev. Rul. 69–604

Advice has been requested as to the Federal income tax treatment of amounts paid by a city health department to alcoholism counselor trainees who are undergoing training in the department's alcoholism center.

A city health department conducts a program to train alcoholism counselors. Its primary objective is to prepare, through an intensive training program, non-professionals to work with alcoholic patients in communities where the problem is found. Each trainee receives a certificate of completion at the end of a six-month training period. The city health department pays the trainees a stated amount during the training period.

Instruction consists of lectures and seminars, with supplementary field placements for brief periods. One such field placement is at the alcoholic rehabilitation units of a state hospital, where for a period of one month a trainee obtains experience, under supervision, in reading records, admission interviewing, and counseling patients. The alcoholic rehabilitation unit supervisor provides the training program director with a written evaluation of each student's performance. A trainee is also assigned for a three-week period to the alcoholism clinic of the city health department where, under the supervision of a clinic staff member, he gains experience in the type of work performed by the staff. Assignments are also made to an emergency room of a general hospital, to the courts, and to the city jails. Each placement facility is expected to provide supervision and to maintain a liaison with the faculty supervisor, who visits the facility at stated intervals to confer with the field supervisor regarding students and policy. During the period of a field placement the trainee returns to the project office for one-half day each week for faculty consultation and supervision, library use, report writing, etc. Trainees observe and participate in regularly scheduled psychotherapy groups during the entire training period.

Trainees are selected by an admissions committee after recruitment efforts by various state and city agencies largely on the basis of their experience in dealing with alcoholics and their desire to do so. Interested clergymen and organizations also participate in the recruitment of trainees. An applicant is not turned down if he indicates that he will not remain in the city or state

after training. There is no requirement that trainees accept employment with the city health department at the completion of their training. Trainees are not city employees and their six-month period of training is not taken into account in fixing employee benefits should they later become employees of the city.

Section 117(a) of the Internal Revenue Code of 1954 excludes from gross income any amount received as a scholarship at an educational institution or as a fellowship grant, including the value of contributed services and accommodations and any amount received to cover expenses for travel, research, clerical help, or equipment, that are incident to such a scholarship or to a fellowship grant, but only to the extent that the amount is so expended by the recipient.

A fellowship grant is defined in section 1.117–3(c) of the Income Tax Regulations as an amount paid to an individual to enable him to pursue study or research. The regulations further provide that the primary purpose of such individual's study or research must be to further his education and training in his individual capacity and the amount provided by the grantor for such purpose must not be compensation or payment for services. Section 1.117–4(c) of the regulations.

Under subsection 117(b)(2) of the Code, in the case of an individual who is not a candidate for a degree, the amount received as a scholarship or a fellowship grant is excludable from gross income only if the grantor is a tax-exempt organization, described in section 501(c)(3) of the Code, or a Government or State instrumentality or agency. In such case, the amount excludable is limited to an amount equal to $300 times the number of months for which the recipient received amounts under the scholarship or fellowship grant during the taxable year. Such exclusion, however, may not be allowed beyond a total of 36 months, whether or not consecutive, even though the amount received during any month may be less than $300.

In the instant case, the primary purpose of the trainees' activities is to further their education and training in their individual capacities and they are not employed by the city, while they are being trained; nor are they required to serve in this capacity upon completion of their training.

Accordingly, it is held that the amounts paid by the city health department under these circumstances to the alcoholism counselor trainees are fellowship grants within the meaning of section 117(a) of the Code and are excludable from gross income to the extent provided in section 117(b)(2)(B) of the Code

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26 CFR 1.117–4: Items not considered as scholarships or fellowship grants.
(Also Sections 3121, 3306, 3402; 31.3121(a)–1, 31.3306(b)–1, 31.3402(a)–1.)

Amounts paid to a college on behalf of a professional ball player pursuant to a baseball club's "College Scholarship Plan" are not excludable from gross income as a scholarship; such amounts are wages for Federal employment tax purposes.

Rev. Rul. 69–424

Advice has been requested whether, under the circumstances described below, the amounts paid to a college on behalf of a taxpayer are excludable from his gross income under the provisions of section 117(a) of the Internal Revenue Code of 1954. If the amounts are not excludable under section 117(a), advice is requested whether they are wages for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24, respectively, subtitle C of the Code).

The taxpayer, a professional baseball player, is under contract with a major league baseball club to play baseball for one of its minor league clubs during June, July, and August, for which he will be paid a specified amount each month. As a part of the contract, the taxpayer entered into a "College Scholarship Plan" agreement with the major league club, in which the club agreed to pay, on his behalf, certain specified expenses in connection with his attendance at an accredited college of his choice, up to a fixed maximum amount per semester. The expenses for which the club shall be liable are limited to the cost of tuition, room and board, text books, and fees. The taxpayer must be enrolled in a regular undergraduate course at an accredited college and must have commenced his studies in the course within a certain period of time.

The unconditional release of the taxpayer or his placement on the league's military list does not relieve the baseball club of the obligation to make the payments under the plan. However, the club is relieved of the obligation to continue the payments should the taxpayer fail to attend an accredited college for two consecutive years without proper reason; fail to report for spring training as directed by his club; or be placed on the voluntarily retired, disqualified, or ineligible list.

The plan is supervised by the Commissioner of Baseball, or by an administrator appointed by him. All payments under the plan are made by the Commissioner of Baseball or by the administrator, subject to reimbursement by the club. All payments under the plan are made to the college attended by the taxpayer.

Subject to certain qualifications and limitations, section 117(a) of the Code provides that gross income of an individual does not include an amount received as a scholarship at an educational institution or as a fellowship grant.

Section 1.117–4 of the Income Tax Regulations provides, in pertinent part, that amounts paid or allowed to, or on behalf of, an individual to enable

him to pursue studies or research are considered to be amounts received as a scholarship or fellowship grant for the purpose of section 117 of the Code if the primary purpose of the studies or research is to further the education and training of the recipient in his individual capacity and the amount provided by the grantor for such purpose does not represent compensation or payment for services. However, any amount or amounts paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research shall not be considered to be an amount received as a scholarship or fellowship grant for the purpose of section 117(a) of the Code if such amount represents either compensation for past, present, or future employment services or payment for services that are subject to the direction or supervision of the grantor, or if such studies or research are primarily for the benefit of the grantor.

In the instant case the taxpayer had signed a contract with the major league club to play baseball for its minor league club. The major league club is obligated to pay for his tuition, room and board, text books and fees, under the conditions stated in the agreement, and to pay him a stated amount per month to play baseball during certain months. All of these payments are made under the employment contract entered into by the taxpayer in consideration for his playing baseball for the club. Thus, these amounts represent "compensation for past, present, or future employment services" within the meaning of section 1.117–4 of the regulations.

Accordingly, under the circumstances described above, no part of the amounts paid to the college on behalf of the player by the baseball club are excludable from his gross income under the provisions of section 117(a) of the Code but are compensation for employment services and are wages subject to income tax withholding under section 3402(a) of the Code. Also, the amounts are wages for purposes of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act.

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26 CFR 1.117–4: Items not considered as scholarships or fellowship grants.
(Also Sections 217, 3121, 3306, 3401, 3402; 1.217–1, 31.3121(a)–1, 31.3306(b)–1, 31.3401(a)–1, 31.3402(a)–1.)

Amounts received from a university by a resident alien conducting research in the United States on a U.S. Government project are taxable wages for Federal tax purposes, not payments under a fellowship grant; expenses incurred moving to the United States are deductible.

Rev. Rul. 69–425

Advice has been requested whether, under the circumstances described below, amounts received by a taxpayer from a university are excludable from his gross income pursuant to the provisions of section 117(a) of the Internal Revenue Code of 1954, and, if not, whether the moving expenses incurred by the taxpayer are deductible pursuant to section 217 of the Code.

The taxpayer, a citizen of New Zealand, a Ph. D. in chemistry, accepted a position as a research associate at a United States university in its department of chemistry. He entered the United States on a P3–1 passport, a third preference passport granted to professional or highly skilled immigrants, and resided here as a resident alien. The university is a private organization of the type described in section 501(c)(3) of the Code that is exempt from Federal income tax under section 501(a) of the Code. It has filed a Form SS–15, Certificate Waiving Exemption from Taxes under the Federal Insurance Contributions Act, as provided by section 3121(k) of the Act (chapter 21, subtitle C, of the Code).

The particular research project for which the taxpayer was employed was supported by a contract entered into between the university and an agency of the United States Government. The taxpayer's skills were extremely relevant to the primary object of the contract. The taxpayer was compensated for his services but contends that the primary purpose of his research conducted at the university was to further his education and training and the amounts received were in the nature of an excludable fellowship.

In moving his family and himself to the United States from New Zealand, the taxpayer incurred traveling expenses and expenses associated with the obtaining of passports. These expenses were incurred during the taxable year in connection with the commencement of work by the taxpayer at a new principal place of work. He received no allowances or reimbursements from the university for these expenses.

Section 117(a) of the Code provides, in pertinent part, that in the case of an individual, gross income does not include any amount received as a fellowship grant.

Section 1.117–4(c) of the Income Tax Regulations provides, in pertinent part, that any amount or amounts paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research shall not be considered to be amounts received as a scholarship or a fellowship grant if such amounts represent either compensation for past, present, or future employment services or represent payment for services that are subject to the direction or supervision of the grantor, or if such studies or research are primarily for the benefit of the grantor.

Section 217(a) of the Code allows, as a deduction, moving expenses paid or incurred during the taxable year in connection with the commencement of work by the taxpayer as an employee at a new principal place of work.

Section 217(b)(1) of the Code provides that the term "moving expenses" means only the reasonable expenses of moving household goods and personal effects from the former residence to the new residence, and of traveling (including meals and lodging) from

the former residence to the new place of residence.

The test under the regulations applicable to section 117 of the Code is whether amounts paid or allowed to an individual are amounts paid or allowed primarily to aid the individual in the pursuit of study or research or whether such amounts represent compensation for services primarily for the benefit of the grantor.

In the instant case, the taxpayer was hired by the university to conduct research in order to assist in satisfying the contract entered into by the university with the agency of the United States Government. The activities of the taxpayer were conducted primarily for the benefit of the grantor. Any knowledge gained by the taxpayer while working was merely incidental to what was essentially an employment relationship.

Accordingly, under the circumstances described, it is held that the amounts received by the taxpayer are not excludable from gross income under section 117 of the Code, but represent compensation for services rendered or to be rendered and are "wages" subject to income tax withholding under section 3402(a) of the Code. The amounts are also subject to the taxes imposed by the Federal Insurance Contributions Act. However, since the university is an organization described in section 501(c)(3) of the Code which is exempt from income tax under section 501(a) of the Code, services performed in its employ are excepted from "employment" for purposes of the Federal Unemployment Tax Act (chapter 23, subtitle C, of the Code) as provided in section 3306(c)(8) of that Act.

It is held further that the taxpayer may deduct his expenses for moving from his former residence in New Zealand to his new residence in the United States provided he otherwise meets the requirements of section 217 of the Code. Included in these moving expenses are the costs associated with obtaining the passports.

26 CFR 1.117-4: Items not considered as scholarships or fellowship grants.

Ct. D. 1926

SUPREME COURT OF THE UNITED STATES

No. 473.—October Term, 1968

John H. Bingler, District Director of Internal Revenue, Petitioner

v.

Richard E. Johnson, et al.

[394 U.S. 741]

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

[April 23, 1969]

MR. JUSTICE STEWART delivered the opinion of the Court.

We are called upon in this case to examine for the first time § 117 of the Internal Revenue Code of 1954, which excludes from a taxpayer's gross income amounts received as "scholarships" and "fellowships." The question before us concerns the tax treatment of payments received by the respondents [1] from their employer, the Westinghouse Electric Corporation, while they were on "educational leave" from their jobs with Westinghouse.

During the period here in question the respondents held engineering positions at the Bettis Atomic Power Laboratory in Pittsburgh, Pennsylvania, which Westinghouse operates under a "cost-plus" contract with the Atomic Energy Commission. Their employment status enabled them to participate in what is known as the Westinghouse Bettis Fellowship and Doctoral Program. That program, designed both to attract new employees seeking further education and to give advanced training to persons already employed at Bettis, offers a two-phase schedule of subsidized postgraduate study in engineering, physics, or mathematics.

Under the first, or "work-study" phase, a participating employee holds a regular job with Westinghouse and in addition pursues a course of study at either the University of Pittsburgh or Carnegie-Mellon University.[2] The employee is paid for a 40-hour work week, but may receive up to eight hours of "release time" per week for the purpose of attending classes.[3] "Tuition remuneration," as well as reimbursement for various incidental academic expenses, is provided by the company.[4]

When an employee has completed all preliminary requirements for his doctorate, he may apply for an educational leave of absence, which constitutes the second phase of the Fellowship Program. He must submit a proposed dissertation topic for approval by Westinghouse and the AEC. Approval is based, *inter alia,* on a determination that the topic has at least some general relevance to the work done at Bettis. If the leave of absence is secured, the employee devotes his full attention, for a period of at least several months,[5] to fulfilling his dissertation requirement. During this period he receives a "stipend" from Westinghouse, in an amount based on a specified percentage (ranging from 70% to 90%) of his prior salary plus "adders," depending upon the size of his family.[6] He also retains his seniority status and receives all employee benefits, such as insurance and stock option privileges. In return he must not only submit periodic progress reports, but under the written agreement that all participants in the program must sign, he is obligated to return to the employ of Westinghouse for a period of at least two years fol-

[1] We refer only to respondents Richard E. Johnson, Richard A. Wolfe, and Martin L. Pomerantz; their wives are parties to this action solely because joint tax returns were filed for the years in question.

[2] Formerly Carnegie Institute of Technology.

[3] A maximum of 156 hours of release time per year is allowed.

[4] The Fellowship Program is funded jointly by Westinghouse and the AEC, but the amounts paid to participating employees are channeled through the company's payroll office.

[5] The ordinary leave period is nine months.

[6] Maximum monthly limits are placed on the amounts paid.

lowing completion of his leave.[7] Upon return he is, according to the agreement, to "assume duties commensurate with his education and experience," at a salary "commensurate with the duties assigned."

The respondents all took leaves under the Fellowship Program at varying times during the period 1961–1962,[8] and eventually received their doctoral degrees in engineering. Respondents Johnson and Pomerantz took leaves of nine months and were paid $5,670 each, representing 80% of their prior salaries at Westinghouse. Respondent Wolfe, whose leave lasted for a year, received $9,698.90, or 90% of his previous salary. Each returned to Westinghouse for the required period of time following his educational leave.

Westinghouse, which under its own accounting system listed the amounts paid to the respondents as "indirect labor" expenses, withheld federal income tax from those amounts.[9] The respondents filed claims for refund, contending that the payments they had received were "scholarships," and hence were excludable from income under § 117 of the Code, which provides in pertinent part:

"(a) *General Rule.*—In the case of an individual, gross income does not include—

"(1) any amount received—

"(A) as a scholarship at an educational institution (as defined in section 151(e)(4)), or

"(B) as a fellowship grant . . . ."[10]

When those claims were rejected, the respondents instituted this suit in the District Court for the Western District of Pennsylvania against the District Director of Internal Revenue. After the basically undisputed evidence regarding the Bettis Program had been presented, the trial judge instructed the jury in accordance with Treas. Reg. § 1.117–4(c), which provides that amounts representing "compensation for past, present, or future employment services," and amounts "paid . . . to . . . an individual to enable him to pursue studies or research primarily for the benefit of the grantor," are not excludable as scholarships.[11] The jury found that the

[7] Respondent Wolfe began his leave at a time when Westinghouse did not require agreement in writing to the two-year "return" commitment. He was formally advised before he went on leave, however, that he was "expected" to return to Westinghouse for a period of time equal to the duration of his leave, and he in fact honored that obligation.

[8] Respondent Wolfe was on leave from March 1, 1960, to February 28, 1961; respondent Johnson from October 1, 1960, to June 30, 1961; and respondent Pomerantz from November 1, 1961, to July 31, 1962.

[9] Tuition and incidental fees were also paid by Westinghouse, but no withholding was made from those payments, and their tax status is not at issue in this case. Although conceptually includable in income, such sums presumably would be offset by educational expense deductions. See Treas. Reg. § 1.162–5.

[10] The entire section reads as follows:

"§ 117. Scholarships and fellowship grants.

"(a) General rule.

"In the case of an individual, gross income does not include—

"(1) any amount received—

"(A) as a scholarship at an educational institution (as defined in section 151(e)(4)), or

"(B) as a fellowship grant, including the value of contributed services and accommodations; and

"(2) any amount received to cover expenses for—

"(A) travel,

"(B) research,

"(C) clerical help, or

"(D) equipment,

"which are incident to such a scholarship or to a fellowship grant, but only to the extent that the amount is so expended by the recipient.

"(b) Limitations.

"(1) Individuals who are candidates for degrees.

"In the case of an individual who is a candidate for a degree at an educational institution (as defined in section 151(e)(4)), subsection (a) shall not apply to that portion of any amount received which represents payment for teaching, research, or other services in the nature of part-time employment required as a condition to receiving the scholarship or the fellowship grant. If teaching, research, or other services are required of all candidates (whether or not recipients of scholarships or fellowship grants) for a particular degree as a condition to receiving such degree, such teaching, research, or other services shall not be regarded as part-time employment within the meaning of this paragraph.

"(2) Individuals who are not candidates for degrees.

"In the case of an individual who is not a candidate for a degree at an educational institution (as defined in section 151(e)(4)), subsection (a) shall apply only if the condition in subparagraph (A) is satisfied and then only within the limitations provided in subparagraph (B).

"(A) Conditions for exclusion.

"The grantor of the scholarship or fellowship grant is—

"(i) an organization described in section 501(c)(3) which is exempt from tax under section 501(a),

"(ii) a foreign government,

"(iii) an international organization, or a binational or multinational education and cultural foundation or commission created or continued pursuant to the Mutual Educational and Cultural Exchange Act of 1961, or

"(iv) the United States, or an instrumentality or agency thereof, or a State, a territory, or a possession of the United States, or any political subdivision thereof, or the District of Columbia.

"(B) Extent of exclusion.

"The amount of the scholarship or fellowship grant excluded under subsection (a)(1) in any taxable year shall be limited to an amount equal to $300 times the number of months for which the recipient received amounts under the scholarship or fellowship grant during such taxable year, except that no exclusion shall be allowed under subsection (a) after the recipient has been entitled to exclude under this section for a period of 36 months (whether or not consecutive) amounts received as a scholarship or fellowship grant while not a candidate for a degree at an educational institution (as defined in section 151(a)(4))."

[11] "§ 1.117–4. Items not considered as scholarships or fellowship grants

"The following payments or allowances shall not be considered to be amounts received as a scholarship or a fellowship grant for the purpose of section 117:

"(c) Amounts paid as compensation for services or primarily for the benefit of the grantor.

"(1) Except as provided in paragraph (a) of § 1.117–2, any amount paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research, if such amount represents either compensation for past, present, or future employment services or represents payment for services which are subject to the direction or supervision of the grantor.

"(2) Any amount paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research primarily for the benefit of the grantor. However, amounts paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research are considered to be amounts received as a scholarship or fellowship grant for the purpose of section 117 if the primary purpose of the studies or research is to further the education and training of the recipient in his individual capacity and the amount provided by the grantor for such purpose does not represent compensation or payment for the services described in subparagraph (1) of this paragraph. Neither the fact that the recipient is required to furnish reports of his progress to the grantor, nor the fact that the results

amounts received by the respondents were taxable income. Respondents then sought review in the Court of Appeals for the Third Circuit, and that court reversed, holding that the Regulation referred to was invalid, that the jury instructions were therefore improper, and that on the essentially undisputed facts it was clear as a matter of law that the amounts received by the respondents were "scholarships" excludable under § 117. 396 F. 2d 258.

The holding of the Court of Appeals with respect to Treas. Reg. § 1.117–4 (c) was contrary to the decisions of several other circuits—most notably, that of the Fifth Circuit in *Ussery* v. *United States*, 296 F. 2d 582, which explicitly sustained the Regulation against attack and held amounts received under an arrangement quite similar to the Bettis Program to be taxable income.[12] Accordingly, upon the District Director's petition, we granted certiorari to resolve the conflict and to determine the proper scope of § 117 and Treas. Reg. § 1.117–4(c) with respect to payments such as those involved here. 393 U.S. 949.

In holding invalid the Regulation that limits the definitions of "scholarship" and "fellowship" so as to exclude amounts received as "compensation," the Court of Appeals emphasized that the statute itself expressly adverts to certain situations in which funds received by students may be thought of as remuneration. After the basic rule excluding scholarship funds from gross income is set out in § 117(a), for instance, subsection (b)(1) stipulates:

"In the case of an individual who is a candidate for a degree at an educational institution . . . , subsection (a) shall not apply to that portion of any amount received which represents payment for teaching, research, or other services in the nature of part-time employment required as a condition to receiving the scholarship or the fellowship grant." [13]

In addition, subsection (b)(2) limits the exclusion from income with regard to nondegree candidates in two respects: first, the grantor must be a governmental agency, an international organization, or an organization exempt from tax under §§ 501 (a), (c)(3) of the Code; and second, the maximum exclusion from income available to a nondegree candidate is $300 per month for not more than 36 months. Since these exemptions are expressly set out in the statute, the Court of Appeals, relying on the canon of construction that *expressio unius est exclusio alterius*, concluded that no additional restrictions may be put on the basic exclusion from income granted by subsection (a)—a conclusion forcefully pressed upon us by the respondents.

Congress' express reference to the limitations just referred to concededly lends some support to the respondents' position. The difficulty with that position, however, lies in its implicit assumption that those limitations are limitations on an exclusion of *all funds* received by students to support them during the course of their education. Section 117 provides, however, only that amounts received as "scholarships" or "fellowships" shall be excludable. And Congress never defined what it meant by the quoted terms. As the Tax Court has observed:

"[A] proper reading of the statute requires that before the exclusion comes into play there must be a determination that the payment sought to be excluded has the normal characteristics associated with the term 'scholarship.'" *Elmer L. Reese, Jr.*, 45 T.C. 407, 413, aff'd, 373 F. 2d 742.

The regulation here in question represents an effort by the Commissioner to supply the definitions that Congress omitted.[14] And it is fundamental, of course, that as "contemporaneous constructions by those charged with administration of" the Code, the Regulations "must be sustained unless unreasonable and plainly inconsistent with the revenue statutes," and "should not be overruled except for weighty reasons." *Commissioner* v. *South Texas Lumber Co.*, 333 U.S. 496, 501 [Ct. D. 1697, C.B. 1948–1, 82]. In this

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of his studies or research may be of some incidental benefit to the grantor shall, of itself, be considered to destroy the essential character of such amount as a scholarship or fellowship grant."

[12] Generally in accord with *Ussery* are *Reese* v. *Commissioner*, 373 F. 2d 742 (C.A. 4th Cir.); *Stewart* v. *United States*, 363 F. 2d 355 (C.A. 6th Cir.); and *Woddail* v. *Commissioner*, 321 F. 2d 721 (C.A. 10th Cir.). See also *Reiffen* v. *United States*, 376 F. 2d 883 (Ct. Cl.).

[13] Subsection (b) goes on to except from that limitation situations in which "teaching, research, or other services are required of all candidates (whether or not recipients of scholarships or fellowship grants) for a particular degree as a condition to receiving such degree . . . ." In those situations, scholarship or fellowship funds received for such services are nontaxable. See n. 10, *supra*.

[14] See also Treas. Reg. §§ 1.117–3 (a), (c), which sets out the "normal characteristics" associated with scholarships and fellowships:

"§ 1.117–3 Definitions.

"(a) Scholarship. A scholarship generally means an amount paid or allowed to, or for the benefit of, a student, whether an undergraduate or a graduate, to aid such individual in pursuing his studies. The term includes the value of contributed services and accommodations (see paragraph (d) of this section) and the amount of tuition, matriculation, and other fees which are furnished or remitted to a student to aid him in pursuing his studies. The term also includes any amount received in the nature of a family allowance as a part of a scholarship. However, the term does not include any amount provided by an individual to aid a relative, friend, or other individual in pursuing his studies where the grantor is motivated by family or philanthropic considerations. If an educational institution maintains or participates in a plan whereby the tuition of a child of a faculty member of such institution is remitted by any other participating educational institution attended by such child, the amount of the tuition so remitted shall be considered to be an amount received as a scholarship.

"(c) Fellowship grant. A fellowship grant 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. The term includes the value of contributed services and accommodations (see paragraph (d) of this section) and the amount of tuition, matriculation, and other fees which are furnished or remitted to an individual to aid him in the pursuit of study or research. The term also includes any amount received in the nature of a family allowance as a part of a fellowship grant. However, the term does not include any amount provided by an individual to aid a relative, friend, or other individual in the pursuit of study or research where the grantor is motivated by family or philanthropic considerations."

We are not concerned in this case with distinctions between the terms "scholarship" and "fellowship."

respect our statement last Term in *United States* v. *Correll,* 389 U.S. 299 [Ct. D. 1917, C.B. 1968–1, 64], bears emphasis:

"[W]e do not sit as a committee of revision to perfect the administration of the tax laws. Congress has delegated to the Commissioner, not to the courts, the task of prescribing 'all needful rules and regulations for the enforcement' of the Internal Revenue Code. 26 U.S.C. § 7805(a). In this area of limitless factual variations, 'it is the province of Congress and the Commissioner, not the courts, to make the appropriate adjustments.' " *Id.,* at 306–307.

Here, the definitions supplied by the Regulation clearly are prima facie proper, comporting as they do with the ordinary understanding of "scholarships" and "fellowships" as relatively disinterested, "no-strings" educational grants, with no requirement of any substantial *quid pro quo* from the recipients.

The implication of the respondents' *expressio unius* reasoning is that any amount paid for the purpose of supporting one pursuing a program of study or scholarly research should be excludable from gross income as a "scholarship" so long as it does not fall within the specific limitations of § 117 (b). Pay received by a $30,000 per year engineer or executive on a leave of absence would, according to that reasoning, be excludable as long as the leave was granted so that the individual could perform work required for a doctoral degree. This result presumably would not be altered by the fact that the employee might be performing, in satisfaction of his degree requirements, precisely the same work which he was doing for his employer prior to his leave and which he would be doing after his return to "employment"—or by the fact that the fruits of that work were made directly available to and exploited by the employer. Such a result would be anomalous indeed, especially in view of the fact that under § 117 the comparatively modest sums received by part-time teaching assistants are clearly subject to taxation.[15] Particularly in light of the principle that exemptions from taxation are to be construed narrowly,[16] we decline to assume that Congress intended to sanction—indeed, as the respondents would have it, to compel—such an inequitable situation.[17]

The legislative history underlying § 117 is, as the Court of Appeals recognized, "far from clear." [18] We do not believe, however, that it precludes, as "plainly inconsistent" with the statute, a definition of "scholarship" that excludes from the reach of that term amounts received as compensation for services performed. The 1939 Internal Revenue Code, like predecessor Codes, contained no specific provision dealing with scholarship grants. Whether such grants were includable in gross income depended simply upon whether they fell within the broad provision excluding from income amounts received as "gifts." [19] Thus case-by-case determinations regarding grantors' motives were necessary. The cases decided under this approach prior to 1954 generally involved two types of financial assistance: grants to research or teaching assistants—graduate students who perform research or teaching services in return for their stipends—and foundation grants to post-doctoral researchers. In cases decided shortly before the 1954 Code was enacted, the Tax Court, relying on the "gift" approach to scholarships and fellowships, held that amounts received by a research assistant were taxable income,[20] but reached divergent results in situations involving grants to post-doctoral researchers.[21]

In enacting § 117 of the 1954 Code, Congress indicated that it wished to eliminate the necessity for reliance on "case-by-case" determinations with respect to whether "scholarships" and "fellowhsips" were excludable as "gifts." Upon this premise the respondents hinge their argument that Congress laid down a standard under which all case-by-case determinations—such as those that may be made under Treas. Reg. § 1.117–4(c)—are unnecessary and improper. We have already indicated, however, our reluctance to believe that § 117 was designed to exclude from taxation all amounts, no matter how large or from what source, that are given for the support of one who happens to be a student. The sounder inference is that Congress was merely "recogni[zing] that scholarships and fellowships are sufficiently unique . . . to merit [tax] treatment separate from that accorded gifts," [22] and attempting to provide that grants falling within those categories should be treated consistently—as in some instances, under the generic provisions of the 1939 Code, they arguably had not been. Delineation of the precise contours of those categories was left to the Commissioner.

Furthermore, a congressional intention that not all grants received by students were necessarily to be "scholarships" may reasonably be inferred from the legislative history. In explaining the basis for its version of § 117 (b) (2),[23] the House Ways and Means

[15] Cf. 1 J. Mertens, Law of Income Taxation, § 7.42, at 110 (Zimet & Oliver rev. ed. 1962).

[16] See *Commissioner* v. *Jacobson,* 336 U.S. 28, 48–49 [Ct. D. 1712, C.B. 1949–1, 40]; *Helvering* v. *Northwest Steel Rolling Mills, Inc.,* 311 U.S. 46, 49 [Ct. D. 1468, C.B. 1940–2, 181].

[17] The opinion of the Court of Appeals reiterates that the stipends received by the respondents were "reasonable." Those payments approximated, of course, the respondent's previous engineering salaries. In any event, given the court's *expressio unius* reasoning, the source of a limitation based on the "reasonableness" of amounts granted to bona fide students is difficult to identify.

[18] 396 F. 2d, at 263.

[19] Int. Rev. Code of 1939, c. 1, § 22(b)(3), 53 Stat. 10; see Int. Rev. Code of 1954, § 102.

[20] See, *e.g., Banks* v. *Commissioner,* 17 T.C. 1386.

[21] Compare *Ti Li Loo* v. *Commissioner,* 22 T.C. 220 (university grant for National Health Service research held taxable), with *Stone* v. *Commissioner,* 23 T.C. 254 (foundation grant held nontaxable).

[22] Gordon, Scholarship and Fellowship Grants as Income: A Search for Treasury Policy, 1960 Wash. U.L.Q. 144, 151.

[23] That version provided for the exclusion only of grants that, together with compensation received from the recipient's former employer, were less than 75% of his salary for the preceding year. Noting that

Committee stated that its purpose was to "tax those grants which are in effect merely payments of a salary during a period while the recipient is on leave from his regular job." [24] This comment related, it is true, to a specific exception to the exclusion from income set out in subsection (a). But, in view of the fact that the statute left open the definitions of "scholarship" and "fellowship," it is not unreasonable to conclude that in adding subsection (b) to the statute Congress was merely dealing explicitly with those problems that had come explicitly to its attention—*viz.*, those involving research and teaching assistantships and post-doctoral research grants—without intending to forbid application to similar situations of the general principle underlying its treatment of those problems. One may justifiably suppose that the Congress that taxed funds received by "part-time" teaching assistants, presumably on the ground that the amounts received by such persons really represented compensation for services performed,[25] would also deem proper a definition of "scholarship" under which comparable sorts of compensation—which often, as in the present case, are significantly greater in amount—are likewise taxable.[26] In providing such a definition, the Commissioner has permissibly implemented an underlying congressional concern.[27] We cannot say that the provision of Treas. Reg. § 1.117–4(c) that taxes amounts received as "compensation" is "unreasonable or plainly inconsistent with the . . . statut[e]." [28]

Under that provision, as set out in the trial court's instructions,[29] the jury here properly found that the amounts received by the respondents were taxable "compensation" rather than excludable "scholarships." [30] The employer-employee relationship involved is immediately suggestive, of course, as is the close relation between the respondents' prior salaries and the amount of their "stipends." In addition, employee benefits were continued. Topics were required to relate at least generally to the work of the Bettis Laboratory. Periodic work reports were to be submitted. And, most importantly, Westinghouse unquestionably extracted a *quid pro quo* for its grants. The respondents not only were required to hold positions with Westinghouse throughout the "work-study" phase of the program, but also were obligated to return to Westinghouse's employ for a substantial period of time after com-

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the House bill would have taxed many modest grants simply because the recipient had no substantial earned income in the previous year, the Senate rejected that formulation and substituted the present $300 per month, 36-month provision of § 117(b)(2). See H.R. Rep. No. 1337, 83d Cong., 2d Sess., 17; S. Rep. No. 1622, 83d Cong., 2d Sess., 18.

[24] H.R. Rep. No. 1337, *supra*, at 17.

[25] The House version of § 117(b)(1) taxed only amounts received as payment for teaching and research services. The Senate amended the provision, however, to include payments for "other services" as well. See S. Rep. No. 1622, *supra*, at 18.

[26] In connection with the question of what Congress may have intended to denote by the terms "scholarship" and "fellowship," it is noteworthy that the House Report stated, "Such grants generally are of small amount and are usually received by individuals who would have little or no tax liability in any case." H.R. Rep. No. 1337, *supra*, at 17.

[27] The Court of Appeals viewed the "primary purpose" of § 117 as the "encourage [ment of] financial aid to education through tax relief." 396 F. 2d, at 262. But while some desire to aid scholarship students no doubt underlay enactment of the statute, that desire must be reconciled with an apparent congressional intent—manifested in the limitations set out in subsection (b)—to tax amounts that represent compensation for services performed. As the text makes clear, we cannot view the Commissioner's attempt to achieve that reconciliation as improper.

[28] The Court of Appeals seems to have recognized that in some circumstances the Commissioner's approach is justified. Its opinion stated:

"A significant commitment by the student in return for a grant would, of course, place that grant outside the category 'scholarship,' at least to the extent of the value of that commitment. For if the grantee had to barter for his stipend, giving full value for it, this arrangement would hardly serve the primary purpose of the § 117 exclusion: to encourage financial aid to education through tax relief." 396 F. 2d, at 262.

It is not clear how this position can be squared with the Court of Appeals' holding that Treas. Reg. § 1.117–4(c) is invalid. In any event, as we suggest *infra*, we cannot agree with the conclusion of the Court of Appeals that the grants received by the respondents were not "bartered for."

[29] The instructions included, *inter alia*, the following passage:

"You are . . . instructed that, one, any amount of money paid to an individual to enable him to pursue studies or research, if such amount represents either compensation for past, present or future employment services, or represents payment for services which are subject to the direction or supervision of the grantor, . . . is not a scholarship or fellowship under the tax laws.

"Two, any amount of money paid to an individual to enable him to pursue studies or research which studies or research are primarily for the benefit of the grantor is not a scholarship under the tax laws."

[30] We thus endorse the decisions of the Fifth and Sixth Circuits in *Ussery* v. *United States*, 296 F. 2d 582, and *Stewart* v. *United States*, 363 F. 2d 355. In *Ussery*, the Court of Appeals for the Fifth Circuit specifically upheld Treas. Reg. § 1.117–4(c) and held taxable monthly payments received by an employee of the Mississippi Department of Public Welfare who had been given leave to secure a Master's Degree in social work. The taxpayer there received employee benefits while on leave, and was obligated to return to the department following completion of his studies. *Stewart* involved a similar arrangement under which an employee of the Tennessee Department of Public Welfare received monthly stipends and other benefits during an educational leave of absence but was required to return thereafter to her previous position. See *Reese* v. *Commissioner*, 373 F. 2d 742 (C.A. 4th Cir.), affirming 45 T.C. 407 (student-teacher); *Woddail* v. *Commissioner*, 321 F. 2d 721 (C.A. 10th Cir.) (resident physician; obligated to remain following part-time participation in training program); cf. *Reiffen* v. *United States*, 376 F. 2d 883 (Ct. Cl.) (relying solely on characterization of payments as "primarily for benefit of grantor"). Several Tax Court decisions point in the same direction, although treatment of various factual situations under § 117 has not been marked by a great deal of consistency. See generally Tabac, Scholarship and Fellowship Grants: An Administrative Merry-Go-Round, 46 Taxes 485 (1968).

The Commissioner has acquiesced in *Evans* v. *Commissioner*, 34 T.C. 720 (see 1965–1 Cum. Bull. 4), which allowed exclusion where, although the taxpayer was obligated to work for the grantor following completion of her studies, there had been no previous employment relationship. See Rev. Rul. 65–146, 1965–1 Cum. Bull. 66. We are informed by the Solicitor General, however, that the *Evans* acquiescence will be modified. See also *Broniwitz* v. *Commissioner*, P–H 1968 T.C. Mem. Dec. ¶ 68,221 (Sept. 30, 1968) (requirement of summer employment with grantor; held excludable).

pletion of their leave.[31] The thrust of the provision dealing with compensation is that bargained-for payments, given only as a *quo* in return for the *quid* of services rendered—whether past, present, or future—should not be excludable from income as "scholarship" funds.[32] That provision clearly covers this case.

[31] The contract's provision that employees who avail themselves of educational leave will be assigned duties "commensurate with [their] education and experience," and compensated at rates "commensurate with" those duties, is hardly sufficient to avoid the clear inference that their grants are fully bargained for and in the nature of compensation. The program is featured in Westinghouse's recruiting efforts as a benefit attractive to many potential employees. Moreover, as suggested in the text, participation in the program undeniably means giving up the right to take more remunerative employment elsewhere for a considerable period of time. Had the company modified its program so that the amounts of the "fellowship" grants were spread over the years preceding and following the educational leave—as increments to the respondents' salary, set aside in a company administered "educational funds"—there could be little doubt that those amounts would have represented compensation. We see no persuasive reason why a different tax result should be reached under Treas. Reg. § 1.117–4(c) on the actual facts involved here. There is no merit in the respondents' oblique suggestion that payment for *present* services is somehow different, with respect to the question before us, from deferred or anticipatory payments.

[32] We accept the suggestion in the Government's brief that the second paragraph of Treas. Reg. § 1.117–4(c)—which excepts from the definition of "scholarship" any payments that are paid to an individual "to enable him to pursue studies or research primarily for the benefit of the grantor"—is merely an adjunct to the initial "compensation" provision:

"By this paragraph, the Treasury has supplemented the first in order to impose tax on bargained-for arrangements that do not create an employer-employee relation, as, for example, in the case of an independent contractor. But the general idea is the same: 'scholarship' or 'fellowship' does not include arranagements where the recipient receives money and in return provides a *quid pro quo*." Brief for petitioner, at 40.

The respondents point out that the Internal Revenue Service is considering possible revisions of the Regulations under § 117. The Solicitor General informs us, however, that although revisions might "conform the Regulations to the results reached" in such cases as *Wells* v. *Commissioner*, 40 T.C. 40, no changes are contemplated with respect to situations such as that involved here. Reply Brief for Petitioner in support of certiorari, at 3, n. 2; see Rev. Rul. 65–59, 1965–1, Cum. Bull. 67.

Accordingly, the judgment of the Court of Appeals is reversed, and that of the District Court reinstated.

It is so ordered.

MR. JUSTICE DOUGLAS would affirm the judgment for the reasons stated by the Court of Appeals in 396 F. 2d 258.

Section 118.—Contributions to the Capital of a Corporation

26 CFR 1.118–1: Contributions to the capital of a corporation.

Treatment of stock of a corporation contributed to the corporation by a shareholder and distributed by the company to its employees. See Rev. Rul. 69–368, page 27.

Part VI. Itemized Deductions for Individuals and Corporations

Section 162.—Trade or Business Expenses

26 CFR 1.162–1: Business expenses.
(Also Section 61; 1.61–1.)

Premiums paid by a bank on insurance policies to cover its liability for wrongful acts committed by its officers and to reimburse officers for expenses arising from such acts are deductible business expenses; no income results to the officers from such premium payments.

Rev. Rul. 69–491

Advice has been requested concerning the deductibility of premiums paid on each of two group insurance policies by a corporate taxpayer for liability insurance covering wrongful acts of its officers and directors under the circumstances described below. Advice has also been requested whether premiums paid by the taxpayer on the policy that would reimburse the officers and directors for their expenses arising from their wrongful acts are includible in their gross income.

A corporate taxpayer engaged in the business of banking purchased two group liability insurance policies. The first policy indemnifies the bank against damages sustained as a result of wrongful acts committed, or alleged to have been committed, by its directors and officers while acting in their official capacities. The second policy indemnifies the officers and directors of the taxpayer for their expenses arising from such wrongful acts committed or alleged to have been committed in their capacity as officers and directors. The "wrongful acts" specified are defined in each policy as any error or misstatement or misleading statement or wrongful act or omission, or neglect or breach of duty by the officers and directors, or any matter claimed against them in their individual or collective capacities as directors or officers of the corporation.

The liability coverage under the policies is limited solely to business acts. The purpose of the taxpayer entering into the policy contracts is to assure the bank that its officers and directors can make banking business decisions without fear of legal entanglement. Each group insurance policy is issued for a three-year period and automatically covers new directors or officers of the taxpayer and any subsidiaries acquired or created after the inception of the policy subject to notice being given the insurer and the payment of any additional premium required.

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 in carrying on a trade or business.

Section 1.162–1(a) of the Income Tax Regulations includes as business expenses, insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business.

Section 61(a)(1) of the Code defines gross income as including compensation for services, including fees, commissions, and similar items.

The premiums on each of the two group policies in question are paid to meet an obligation of the employer on account of the employment of its officers and directors, and thus are incurred in connection with the employer's trade or business. Those premiums are analogous to the type

specified in section 1.162–1(a) of the regulations which are deductible as ordinary and necessary business expenses.

Accordingly, it is held that the premiums paid on each of the group liability insurance policies described above are ordinary and necessary business expenses which are deductible under section 162(a) of the Code.

The premiums for the second group policy, which indemnifies the officers and directors for their wrongful acts performed in their official capacities, are paid by the taxpayer to protect its business by limiting its liability for such wrongful acts and to assure the taxpayer that its officers and directors can make necessary corporate decisions without fear of legal entanglement. Thus, the costs are incurred for the benefit of the taxpayer rather than for the benefit of the officers. Accordingly, it is further held that the premiums paid for liability coverage under the second group liability insurance policy are not includible as income by the officers and directors of the taxpayer under section 61(a) of the Code.

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26 CFR 1.162–1: Business expenses.
(Also Sections 61, 164; 1.61–1, 1.164–1.)

National banks in Rhode Island that elect to pay the tax assessed by the State against depositors may deduct such taxes as business expenses; the depositor must report such amount as taxable income, but may deduct the amount as taxes paid; I.T. 1388 superseded.

Rev. Rul. 69–497 [1]

The purpose of this Revenue Ruling is to update and restate, under current statute and regulations, the position set forth in I.T. 1388, C.B. I–2, 97 (1922).

The question presented is whether a national bank in Rhode Island may claim a deduction in its Federal income tax return for the current year for taxes paid the State of Rhode Island on customers' savings deposits.

Special provisions relative to the taxing of customer deposits in national banks are contained in Title 44, Chapter 16, National Bank Deposits Law of the State of Rhode Island. The pertinent provisions of which are as follows:

"Sec. 44–16–3 . . . Every person so having a deposit in a national bank as aforesaid shall, except as otherwise provided in this chapter, pay a tax to the state which is hereby assessed at the rate of four-tenths of one percent (.4%) upon the amount of such deposit so held by such national bank on the last business day of June; and no deduction therefrom shall be made on account of any indebtedness or exemption.

"Sec. 44–16–8 * * * If a national bank in this state so elects, it may pay to the state all taxes imposed by this chapter; and it shall be lawful for such bank to deduct such taxes, so paid, from the interest or deposits then or thereafter held by it belonging to the person from whom such tax becomes due.

"Sec. 44–16–9 * * * If a national bank makes the election provided in section 44–16–8, it shall file with the tax administrator a stipulation setting forth such fact. If such stipulation is filed on or before the last business day of June in any year, it shall take effect on said last named date and shall remain in full force and effect until it shall thereafter be revoked as hereinafter provided. No depositor in such bank shall be required to pay the tax or make the returns specified in section 44–16–1 while such stipulation shall remain in force."

Section 162 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.

It is held that if the national banks in Rhode Island elect to pay the tax assessed against depositors in order to compete with State banks and elect to receive no reimbursement from the depositors, the taxes so paid are deductible as business expenses under section 162 of the Code. Further, each depositor in such case is required, under the provisions of section 61 of the Code, to report as taxable income the amount of tax paid on his deposit and may deduct the amount as a tax paid under section 164(a) of the Code.

I.T. 1388 is superseded since the position set forth therein is restated under current law in this Revenue Ruling.

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26 CFR 1.162–1: Business expenses.
(Also Section 74; 1.74–1.)

The cost of an automobile given away as a prize to a customer is deductible as a business expense; the fair market value of the automobile at the date of acquisition is includible in the customer's gross income; I.T. 1667 superseded.

Rev. Rul. 69–510 [1]

A domestic corporation operating restaurants gives each customer a chance to win a new automobile by giving each of them a ticket bearing a number with each meal purchased. At the end of every six months an automobile is given to the customer holding the ticket bearing a certain number.

Held, the corporation may deduct the cost of the automobile as a business expense under the provisions of section 162 of the Internal Revenue Code of 1954. Furthermore, the winner of each car must include in gross income, under section 74 of the Code, the fair market value of the automobile at the date of its acquisition.

I.T. 1667, C.B. II–1, 83 (1923), is hereby superseded, since the position stated therein is set forth under current statute and regulations in this Revenue Ruling.

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26 CFR 1.162–1: Business expenses.
(Also 1.162–11.)

A lump sum payment by a lessee as damages for cancellation of a business lease that is equal to a certain amount for each month of

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

the unexpired term is deductible as a business expense; O.D. 974 superseded.

Rev. Rul. 69–511 [1]

The lessee of business premises paid to the lessor as damages a lump sum in consideration of the lessor's cancellation of a lease for a term of years. The sum paid equaled a certain amount for each month of the unexpired term. *Held,* the amount paid is an allowable deduction as a business expense under section 162 of the Internal Revenue Code of 1954. The amount of the damages is deductible for the year in which actually paid or accrued depending upon the method of accounting used by the lessee.

O.D. 974, C.B. 5, 129 (1921), is hereby superseded since the position stated therein is restated under current statute and regulations in this Revenue Ruling.

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26 CFR 1.162–1: Business expenses.
(Also Section 461; 1.461–1.)

Amounts set aside in a reserve account to cover self-insurance against fire are not deductible as a business expense; S.R. 2586 superseded.

Rev. Rul. 69–512 [1]

Structures erected, maintained, and operated by the taxpayer are constructed of very light wood and are situated in close proximity to other buildings of like flimsy construction. Fire is one of the greatest hazards in the taxpayer's business and constantly endangers, impairs, and threatens its business. The taxpayer was unable to obtain fire insurance on the properties and set aside in a reserve account a percentage of its income to cover losses by fire.

Held, the amounts set aside as a reserve to cover self-insurance are not ordinary and necessary expenses paid or incurred during the taxable year in carrying on its business and no deduction is allowable under section 162 of the Internal Revenue Code of 1954.

See *L. A. Thompson Scenic Railway Co.* v. *Commissioner,* 9 B.T.A. 1203 (1928).

S.R. 2586, C.B. IV–1, 227 (1925), is hereby superseded, since the position stated therein is set forth under the current statute and regulations in this Revenue Ruling.

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26 CFR 1.162–1: Business expenses.

Amounts credited to a reserve fund created by a corporation for stock redemption are not deductible business expenses; O.D. 288 superseded.

Rev. Rul. 69–546 [1]

M, a domestic corporation, established a reserve account for the purpose of ultimately redeeming its preferred stock.

Held, amounts credited to the reserve by *M* corporation are not ordinary and necessary business expenses under section 162 of the Internal Revenue Code of 1954 and are not allowable deductions in computing *M*'s taxable income for Federal income tax purposes.

O.D. 288, C.B. 1, 221 (1919), is hereby superseded since the position stated therein is set forth under current statute and regulations in this Revenue Ruling.

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26 CFR 1.162–1: Business expenses.
(Also Section 461; 1.461–1.)

Deductibility of awards required to be paid employees under a National Labor Relations Board's decision and attorneys' fees incurred in connection therewith; I.T. 3412 superseded.

Rev. Rul. 69–547

The purpose of this Revenue Ruling is to update and restate, under current statute and regulations, the position set forth in I.T. 3412, C.B. 1940–2, 174.

The questions presented are whether awards required to be paid to certain employees as a result of a decision of the National Labor Relations Board (NLRB) are deductible for Federal income tax purposes and whether attorney fees in connection with such action are also deductible.

Prior to the year 1968, the *M* company, on the accrual method of accounting, was involved in labor difficulties in its plant and jurisdiction over the situation was taken by the NLRB. A decision was rendered by the NLRB in 1968 under which *M* company paid to its employees a sum of money approximating $23x$ dollars. *M* company also incurred attorney fees approximating $5x$ dollars in defending its position. The awards of the NLRB represented what the employees would have earned had they not been absent from work as a result of labor difficulties, after subtracting therefrom the amount of wages, if any, which such employees earned elsewhere during such absence. No appeal from the decision was filed by the *M* company and the decision became final in 1968.

The awards in the instant case represent compensatory damages incurred in connection with the operation of *M*'s business. Attorney fees incurred by *M* in defending its position before the NLRB are also incurred in connection with its business. See *Commissioner* v. *Walter F. Tellier, et ux.,* 383 U.S. 687 (1966), Ct. D. 1907, C.B. 1966–1, 32.

Accordingly, the awards in the instant case and the attorney fees incurred in connection with *M*'s defense constitute ordinary and necessary business expenses for the purpose of section 162 of the Code.

Since *M* company has adopted the accrual method, it is entitled to deduct the amount of the awards for the taxable year 1968, the year in which the decision of the NLRB became final. If the legal fees also became a determined liability during the year 1968, *M* is likewise entitled to deduct such fees as a business expense for that year.

I.T. 3412 is hereby superseded, since the position stated therein is restated under the current law in this Revenue Ruling.

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[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

26 CFR 1.162–1: Business expenses.

Income of a revocable trust consisting solely of dividends on stock of the corporate-settlor, that is payable to a corporate officer as additional compensation, may be deducted by the corporation as a business expense if the officer's total compensation is reasonable; I.T. 2358 superseded.

Rev. Rul. 69–559 [1]

M, a domestic corporation, created a revocable trust. The corpus of the trust is held by a bank as trustee and consists of shares of *M*'s capital stock. The income of the trust consisted solely of dividends paid by *M* on its stock. The trust's income, less trustee's fees, was paid to *A*, an officer of the *M* company as additional compensation.

Held, M may deduct, under the provision of section 162(a)(1) of the Internal Revenue Code of 1954, the amount of trust income paid to *A* as additional compensation, provided that such amount together with the other sums paid to *A* as compensation is reasonable. *A* is required to report as compensation, for Federal income tax purposes, the amount of trust income paid to him.

I.T. 2358, C.B. VI–1, 90 (1927), is hereby superseded, since the position stated therein is set forth under the current statute and regulations in this Revenue Ruling.

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26 CFR 1.162–1: Business expenses.
(Also Section 167; 1.167(a)–1.)

The cost of tires and tubes mounted on highway construction equipment may be deductible as a business expense by a purchaser who is both the user and lessor of such equipment.

Rev. Rul. 69–560

Advice has been requested whether the cost of tires and tubes purchased with highway construction equipment by a taxpayer, who is both the user and lessor of such equipment, is deductible as an expense in the taxable year of purchase if their average useful life is less than one year.

The taxpayer is engaged in the highway construction business. It also is engaged in the business of leasing new highway construction equipment. The costs of new highway equipment purchased and leased to others, and that purchased for use in the highway construction business, are both treated by the taxpayer as a capital expenditure to be depreciated over their estimated useful lives. However, since the tires and tubes mounted on the highway equipment (including those mounted on such equipment leased) have an average useful life in the instant case of less than one year, the question has arisen whether the cost of these tires and tubes can be treated as business expense deductible in full in the taxable year of purchase.

Revenue Ruling 59–249, C.B. 1959–2, 55, holds that the cost of tires and tubes on new commercial trucking equipment purchased and used by the taxpayer in motor freight transportation is deductible in full as ordinary and necessary business expenses in the taxable year of purchase and payment (or accrual) if in such use they are consumable within that year or their average useful life is less than one year even though it extends in part into the next year.

Revenue Ruling 68–134, C.B. 1968–1, 63, holds that the conclusion of Revenue Ruling 59–249 is equally applicable to tires in the case of a purchaser who is engaged in the business of leasing such new commercial trucking equipment.

As in Revenue Ruling 59–249 and Revenue Ruling 68–134, the tires and tubes in the instant case have an average useful life of less than one year. Accordingly, the cost of the tires and tubes purchased by the taxpayer on new highway equipment that it uses and that it leases is deductible as ordinary and necessary business expenses in full in the taxable year of purchase and payment (or accrual, where such method of accounting is regularly employed, for Federal income tax purposes, by the taxpayer).

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26 CFR 1.162–1: Business expenses.
(Also Section 263; 1.263(a)–2.)

Brokerage fees paid by a domestic corporation in acquiring its own stock are part of the purchase price and are not ordinary and necessary business expenses deductible under section 162 of the Code; O.D. 852 superseded.

Rev. Rul. 69–561 [1]

M, a domestic corporation, purchased 10*x* shares of its outstanding capital stock for the purpose of holding it as treasury stock or retiring it. In acquiring its stock *M* incurred and paid brokerage fees.

Held, the brokerage fees are not ordinary and necessary business expenses, under section 162 of the Internal Revenue Code of 1954, and are not deductible from gross income. These expenditures are part of the purchase price of the stock so acquired. See *Atzingen-Whitehouse Dairy, Inc.* v. *Commissioner*, 36 T.C. 173 (1961).

O.D. 852, C.B. 4, 286 (1921), is hereby superseded, since the position stated therein is set forth under the current statute and regulations in this Revenue Ruling.

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26 CFR 1.162–1: Business expenses.

Payments by an employer of liquidated damages and reasonable attorney's fees allowed by the courts, pursuant to section 16(b) of the Fair Labor Standards Act of 1938, are deductible business expenses; I.T. 3762 superseded.

Rev. Rul. 69–581 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in I.T. 3762, C.B. 1945, 95.

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[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

The question presented is whether payments by an employer of (1) liquidated damages and (2) reasonable attorney's fees allowed by the courts, pursuant to section 16(b) of the Fair Labor Standards Act of 1938, as amended (29 U.S. Code sections 201–219), are deductible as ordinary and necessary business expenses for Federal income tax purposes.

Section 16(b) of the Act provides in part, as follows:

(b) Any employer who violates the provisions of section 6 [minimum wage] or section 7 [maximum hours] of this Act shall be liable to the employee or employees affected in the amount of their unpaid minimum wages, or their unpaid overtime compensation, as the case may be, and in an additional equal amount as liquidated damages. Action to recover such liability may be maintained in any court of competent jurisdiction by any one or more employees for and in behalf of himself or themselves and other employees similarly situated. No employee shall be a party plaintiff to any such action unless he gives his consent in writing to become such a party and such consent is filed in the court in which such action is brought. The court in such action shall, in addition to any judgment awarded to the plaintiff or plaintiffs, allow a reasonable attorney's fee to be paid by the defendant, and costs of the action. * * * [Brackets added.]

The provisions of section 16(b) of the Fair Labor Standards Act of 1938, are not penal in nature. The liquidated damages provided for therein constitute compensation for delay in the payment of sums due under the Act. See *Overnight Motor Transportation Co., Inc.* v. *Missel,* 316 U.S. 572, and *Brooklyn Savings Bank* v. *O'Neil,* 324 U.S. 697.

Accordingly, it is held that the payments by an employer of (1) liquidated damages, and (2) reasonable attorney's fees allowed by the courts, pursuant to section 16(b) of the Fair Labor Standards Act of 1938, are deductible under the provisions of section 162 of the Internal Revenue Code of 1954 as ordinary and necessary business expenses for Federal income tax purposes.

I.T. 3762 is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

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26 CFR 1.162–1: Business expenses.
(Also Section 263; 1.263(a)–1.)

Fees paid to a registrar and transfer agent for the maintenance of capital stock records, not related to an original issue of stock, merger, consolidation, or stock dividends, are ordinary and necessary business expenses; I.T. 2582 superseded.

Rev. Rul. 69–615 [1]

The purpose of this Revenue Ruling is to update and restate under the current statute and regulations, the position set forth in I.T. 2582, C.B. X–2, 129 (1931).

The question presented is whether certain fees paid by a corporation to its registrar and transfer agent are allowable deductions from gross income.

A corporation listed its stock on a stock exchange and appointed a registrar and transfer agent to whom fees were paid to take care of the registration and transfer of the corporation's capital stock. The expenditures were not incurred as a result of the organization, reorganization or recapitalization of the corporation but were the usual recurring charges that arose during the year in connection with the maintenance of a correct up-to-date record of the company's stockholders.

Although a corporation is formed primarily to engage in a particular business, the corporate organization must be maintained in order to carry on the business for which it is formed. This involves the holding of meetings of the stockholders to elect the officers through which the corporation acts and to vote on matters that require stockholders' sanction. For such purpose proper records showing the names and addresses of the stockholders must be maintained. Except in the case of a corporation whose stock is listed on an exchange, such records are ordinarily maintained by the corporation itself. There is no reason to make a distinction between a corporation that employs a separate registrar and one that maintains its own records.

Accordingly, it is held in the instant case that the fees paid by the corporation to its registrar and transfer agent in connection with the transfer of its capital stock are ordinary and necessary business expenses under section 162 of the Internal Revenue Code of 1954 and are, therefore, allowable deductions from gross income.

Where such expenditures have been incurred in connection with transactions such as mergers, consolidations, original issue of stock, or stock dividends, they are not allowable deductions from gross income. See, for example, *General Bancshares Corporation* v. *Commissioner,* 326 F. 2d 712 (1964), certiorari denied, 379 U.S. 832 (1964).

I.T. 2582 is hereby superseded since the position stated therein is restated under current law in this Revenue Ruling.

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26 CFR 1.162–1: Business expenses.

Whether compensation paid by a corporation engaged in the securities business to persons who have subordinated their accounts to customers and creditors of the corporation is deductible as an ordinary and necessary business expense. See Rev. Rul. 69–455, page 9.

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26 CFR 1.162–2: Traveling expenses.

Whether an ordained, noncompensated minister may deduct as a business expense his automobile expenses incurred while carrying out his duties and obligations as a minister. See Rev. Rul. 69–645, page 37.

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26 CFR 1.162–4: Repairs.

Costs of maintaining purchased or developed computer software. See Rev. Proc. 69–21, page 303.

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

26 CFR 1.162–7: Compensation for personal services.
(Also Sections 61, 118; 1.61–2, 1.118–1.)

The value of stock contributed by a majority stockholder to a corporation, for use at the sole discretion of the corporation, and subsequently distributed by the company to its employees as bonuses, is deductible by the corporation under section 162 of the Code.

Rev. Rul. 69–368

The majority stockholder of a corporation contributed some of his stock to the corporation for it to retire or to hold as treasury stock and use as it saw fit.

Under a plan formulated by the executives of the corporation in a later year, the corporation used the contributed stock to pay a bonus to employees. The number of shares issued to each employee was determined by reference to his length of service and his compensation. The total compensation, including the fair market value of the shares distributed, was reasonable compensation for services rendered by the employees.

Held, under these circumstances, (1) the transfer of the stock to the corporation by the shareholder is a contribution to capital by the shareholder under section 118 of the Internal Revenue Code of 1954 and section 1.118–1 of the Income Tax Regulations, (2) the stock distributed to the employees is includible in the gross income of each employee under section 61 of the Code to the extent of the fair market value of the stock at the date of the distribution, and (3) the fair market value of the stock distributed is deductible by the corporation as compensation under section 162 of the Code.

Compare Revenue Ruling 69–369, this page, relating to a transfer of stock to employees pursuant to a prearranged plan formulated by a corporation and its majority stockholder.

26 CFR 1.162–7: Compensation for personal services.
(Also Section 61; 1.61–2.)

The value of stock transferred by a majority stockholder to a corporation, pursuant to a prearranged plan for distribution by the company to certain of its employees, is not deductible by the corporation under section 162 of the Code.

Rev. Rul. 69–369

Advice has been requested whether a corporation is allowed a deduction under section 162 of the Internal Revenue Code of 1954 as a result of the transfer of stock to its employees under the circumstances described below.

Pursuant to a plant formulated by the majority stockholder of a corporation, he transferred to it some of his stock of the corporation. In accordance with this plan, the corporation then transferred the stock to certain of its employees, the number of shares transferred to each being dependent on the number of years of his service to the corporation. The corporation had no obligation to pay additional compensation to the employees.

Under these circumstances the transfer of the stock by the corporation to its employees will be treated for Federal income tax purposes as if the transfer had been made directly by the majority stockholder to the employees of the corporation.

Accordingly, the value of the stock transferred by the corporation to employees in the instant case is not deductible by the corporation under section 162 of the Code. The fair market value of such shares is includible in the gross income of the employees under the provisions of section 61 of the Code. See Revenue Ruling 69–140, C.B. 1969–1, 46, which holds that shares of stock transferred by the majority stockholder of a corporation to employees of the corporation, the number of shares being dependent on the number of years of service of the employee to the corporation, are not gifts within the meaning of section 102(a) of the Code. It further holds that the value of such shares is includible in the gross income of the employees under section 61 of the Code.

Compare Revenue Ruling 69–368, this page, relating to a contribution of stock to a corporation and the use of such stock, at the sole discretion of the corporation, to pay bonuses to employees.

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26 CFR 1.162–7: Compensation for personal services.
(Also Section 61; 1.61–12.)

Advances, originally intended as loans to commission salesmen but later charged off by the employer, are additional compensation to the salesmen and may be deducted by the employer in the year charged off; I.T. 2043 superseded.

Rev. Rul. 69–465 [1]

The purpose of the Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in I.T. 2043, C.B. III–2, 94 (1924).

The question presented is whether the taxpayer may, under the circumstances described below, deduct advances paid to certain employees.

M company over a period of years had advanced personal and traveling expenses to salesmen who worked for it on a commission basis. The advances to the employees were intended as loans and there was an unconditional personal obligation on the part of the employees to repay the advances. The advances were to be deducted from the commissions earned by the employees. Up to the present time the salesmen have been unable to earn commissions sufficient to offset the advances and *M* company charged off the balance of the advances made to the salesmen in order to relieve them of the handicap of being in debt with the hope that it would be reflected to its advantage through increased sales.

Section 1.162–7 of the Income Tax Regulations provides, in pertinent part, that there may be included among the

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

ordinary and necessary expenses paid or incurred in carrying on any trade or business a reasonable allowance for salaries or other compensation for personal services actually rendered.

It is held that the debts owed *M* company by its employees and charged off during the year represent additional compensation to the employees and are deductible by *M* in the year of the charge-off under section 162 of the Code. Furthermore, the amounts charged off are includible in the salesmen's income for the year in which the charge-off occurs.

I.T. 2043 is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

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26 CFR 1.162–10: Certain employee benefits.

Treatment for taxable years ending on or before June 17, 1969, of premiums paid or incurred under contracts providing group term life and health and accident coverage for active and retired employees where a portion of such premiums is credited to reserves.

Rev. Rul. 69–382 [1]

Advice has been requested whether premiums paid or incurred pursuant to contracts providing for group term life and health and accident coverage for active and retired employees are deductible by the policyholder under section 162(a) of the Internal Revenue Code of 1954 where a portion of the premiums is credited to reserves as described below.

Employers have entered into contracts with life insurance companies providing for renewable one-year group term insurance on all active and retired employees. The amount of the annual premium on such contracts is determined by the insurance company and is the amount estimated to be sufficient to make provision for the expected cost of claims, expenses, and other charges for the policy year. In addition, the premium includes an amount to be added to special reserves established and maintained on behalf of the policyholder pursuant to a written or oral understanding between the policyholder and the life insurance company. These special reserves are of two principal types—a reserve for continued insurance on retired employees ("retired lives" reserve) and a reserve for leveling out the premium cost ("stabilization" reserve). In some instances, the reserve is a combination of both types.

The purpose of the retired lives reserve is to accumulate a fund to be used to pay all or a portion of the cost for continuing insurance coverage on retired employees. The purpose of the stabilization reserve is to equalize the net premium cost to the policyholder and thus to avoid fluctuation in premium cost from year to year by reason of variations in claim experience. The reserve in either case may also be used for the payment of claims and other charges under the contract in any policy year in which such claims and other charges exceed the amount of premiums paid by the policyholder.

The amount of the annual addition to the reserve, whether it constitutes a retired lives reserve, a stabilization reserve, or a combination of both, is the excess of premiums paid by the policyholder over the sum of claims, expenses, and other charges. The reserve is also increased by the addition by the insurance company of amounts designated as interest on the reserve. Prior to the cancellation of the contract (or option provision where either such reserve is established pursuant to a separate option in the insurance contract), the policyholder has no right to withdraw any portion of the reserve. In some instances, upon cancellation the balance in the reserve becomes available as a source of dividends to the policyholders. In others, the balance in the reserve will be used only to pay premiums for continued insurance coverage until the reserve is exhausted. In the latter case, if there are no more employees for whom insurance coverage is to be provided, any balance will be returned to the policyholder.

It is held that for taxable years ending on or before June 17, 1969, annual premiums paid or incurred by the policyholder pursuant to the above-described contracts will be deductible in full notwithstanding the fact that a portion of such premium is credited to a retired lives reserve, a stabilization reserve, or a combination of both, subject to the following two conditions:

(1) The balance in the reserve must be held by the insurance company solely for the purpose of providing insurance coverage on active or retired lives so long as any active or retired employee remains alive; and

(2) The amount added to the retired lives reserve is not greater than an amount which would be required to fairly allocate the cost of the insurance coverage provided over the working lives of the employees involved.

Moreover, the amount designated as interest which is credited to these reserves will not be included in the gross income of the policyholder.

The above conclusions will be applicable to future years in the case of the retired lives reserve provided, however, that the policyholder has no right of recapture of any portion of the reserve so long as any active or retired employee remains alive. Where an existing contract does not deny the policyholder's right to any such recapture, the policyholder and the insurance company must forthwith amend such contract to provide for no right of recapture of any portion as stated above. However, further consideration is being given to the question whether any portion of the addition to a reserve which is exclusively or in part a claim stabilization reserve should be treated as a deferred charge applicable to future operations and for which a current deduction should not be allowed. If such position is adopted, it will be

[1] Also released as Technical Information Release 1016, dated June 17, 1969.

published as a Revenue Ruling and will be applied without retroactive effect pursuant to section 7805(b) of the Code.

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26 CFR 1.162–10: Certain employee benefits.
(Also Section 404; 1.404(a)–1.)

A corporation's nonrefundable contribution to an employees' trust to provide group health and life insurance for both active and retired employees is deductible under section 162 of the Code.

Rev. Rul 69–478

X corporation, under an employee benefit plan, is required to make nonrefundable contributions to a group employee benefit trust. The contributions to the trust are to provide for the payment to insurers for group health insurance as well as to provide for group-term life insurance. The plan covers not only eligible active employees but also eligible retired employees. Contributions are made by the employer on a level basis (actuarially determined) so that at the time of an employee's retirement there is enough money in the fund to enable the trustee to continue to make the premium payments on the contracted insurance.

Held, the fact that some or all of the employees benefited under the plan are retired does not require that the plan be considered a deferred compensation plan governed by the provisions of section 404 of the Internal Revenue Code of 1954. The plan remains an "employee" benefit plan specifically excluded from the application of section 404(a) of the Code. Section 1.404(a)–1(a)(2) of the Income Tax Regulations. The deductibility of the required payments made by *X* under the plan is governed by section 162 of the Code and section 1.162–10 of the regulations. Compare Revenue Ruling 69–382, page 28, this Bulletin, wherein premium payments to an insurance company for group term life and health and accident coverage for both active and retired employees are held to be deductible under section 162 of the Code.

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26 CFR 1.162–11: Rentals.

A royalty paid by a corporation to its majority stockholder-president for the use of a patent on an article manufactured by the corporation is a deductible business expense if the amount is reasonable; O.D. 440 superseded.

Rev. Rul. 69–513 [1]

M, a domestic corporation, paid *A,* its president and owner of a patent, a royalty on each machine it manufactures and sells under *A*'s patent. *A* also owns 52 percent of *M*'s outstanding capital stock.

Held, the royalty paid by *M* to *A* is deductible as a business expense under the provisions of section 162 of the Internal Revenue Code of 1954, provided the amount is reasonable. Payments in excess of a reasonable amount would represent a distribution by the corporation and are not deductible.

O.D. 440, C.B. 2, 215 (1920), is superseded since the position set forth therein is restated under current statute and regulations in this Revenue Ruling.

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26 CFR 1.162–11: Rentals.

Amounts paid by lessee as damages in consideration of lessor's cancellation of lease. See Rev. Rul. 69–511, page 23.

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26 CFR 1.162–11: Rentals.

Cost of leasing computer software. See Rev. Proc. 69–21, page 303.

Section 163.—Interest

26 CFR 1.163–1: Interest deduction in general.

A "loan processing fee" (points) paid by a mortgagor-borrower as compensation to a lender solely for the use or forbearance of money is deductible in full in the year of payment; Revenue Ruling 68–643 modified and Revenue Ruling 69–188 amplified.

Rev. Rul. 69–582

A taxpayer, on the cash receipts and disbursements method of accounting, obtained a mortgage loan of $20,000 for the purchase of a personal residence costing $25,000. The taxpayer agreed to pay to the lender, in addition to interest at the stated annual interest rate of 8%, a "loan processing fee" (sometimes referred to as "points") such as that held to be interest under the facts of Revenue Ruling 69–188, C.B. 1969–1, 54, where it was established that the fee was paid as compensation to the lender solely for the use or forbearance of money. The loan processing fee was $1,200 (six points), and the taxpayer paid the full amount of the fee in the year the loan originated. The taxpayer did not obtain the funds to pay the fee from the lender. Payments on the mortgage and interest thereon were made monthly as they became due.

Revenue Ruling 68–643, C.B. 1968–2, 76, concludes that the deduction of prepaid interest in the year of payment by a taxpayer employing the cash receipts and disbursements method of accounting may not result in a clear reflection of income for the taxable year of payment. The Revenue Ruling holds that where a material distortion of income has been found to result from the deduction of prepaid interest, the Service will require the taxpayer to change his method of accounting with respect to such prepaid interest in order to allocate it over the taxable years involved.

Held, under the facts in the instant case, the deduction for the payment of the $1,200 loan processing fee (points) determined to be interest is not considered to cause a material distortion of income. Therefore, it is allowable as a current deduction without the need for proration as would be required by Revenue Ruling 68–643 in other situations involving prepaid interest.

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[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

Revenue Ruling 68–643 modified; Revenue Ruling 69–188 amplified.

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26 CFR 1.163–1: Interest deduction in general.

Federal income tax and interest equalization tax consequences of an "overseas financing" arrangement. See Rev. Rul. 69–377, page 231.

Section 164.—Taxes

26 CFR 1.164–1: Deduction for taxes.

State and local transfer taxes paid by a corporation on the sale of a building used in the operation of its business are deductible under section 164(a) of the Code.

Rev. Rul. 69–456

In 1968, *X* corporation sold a building it had been using in the operation of its business. *X* paid State and local transfer taxes on the sale.

Held, the State and local transfer taxes paid upon the sale of the building are deductible by *X* as taxes under section 164(a) of the Internal Revenue Code of 1954.

See Revenue Ruling 65–313, C.B. 1965–2, 47, which holds that State and local transfer taxes of individuals that are attributable to a taxpayer's trade or business are deductible under section 164(a) of the Code.

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26 CFR 1.164–1: Deduction for taxes.

A utility use tax imposed by San Bernardino, California, is not a general sales tax deductible under section 164(a)(4) of the Code.

Rev. Rul. 69–532

Advice has been requested whether the utility use tax imposed by the city of San Bernardino, California, pursuant to Ordinance No. 2931 is deductible as a general sales tax under section 164(a)(4) of the Internal Revenue Code of 1954.

Ordinance No. 2931, dated August 12, 1968, imposed a tax of five percent on persons using telephone communication services, electrical energy, gas that is delivered through mains or pipes, and water that is delivered through mains or pipes. In addition to the utility use tax, the city imposes a one percent general sales tax and the State of California imposes a four percent general sales tax.

Section 164(a) of the Code provides, in part, that State and local general sales taxes are allowed as a deduction for the taxable year within which paid or accrued.

Section 164(b)(2) of the Code provides, in part, that the term "general sales tax" means a tax imposed at one rate in respect of the sale at retail of a broad range of classes of items.

Section 1.164–3(g)(1) of the Income Tax Regulations provides, in part, that a sales tax that is general is usually imposed at one rate in respect of the retail sales of all tangible personal property. A sales tax that is selective, that is, a tax that applies at one rate with respect to retail sales of specified classes of items also qualifies as general if the specified classes represent a broad range of classes of items. A selective sales tax that does not apply at one rate to the retail sales of a broad range of classes of items is not general. However, a selective sales tax is deemed to be part of the general sales tax if imposed at the same rate as the general rate of tax that qualifies a tax in the taxing jurisdiction as a general sales tax.

In the instant case, the utility use tax imposed by the city is a selective sales tax that is not general within the meaning of section 1.164–3(g)(1) of the regulations since it is not imposed on a broad range of classes of items. Furthermore, it is imposed at a rate different from the rate of tax imposed by the city as a general sales tax.

The general sales tax rate of the State and the general sales tax rate of the city are not to be combined to determine whether the utility use rate is imposed at the same rate as the general rate of tax since the State and city are different taxing jurisdictions.

Accordingly, it is held that the utility use tax imposed by the city of San Bernardino pursuant to Ordinance No. 2931 is not deductible as a general sales tax under section 164(a)(4) of the Code.

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26 CFR 1.164–1: Deduction for taxes.

A local excise tax imposed on gross sales of liquor by a "nonprofit" liquor dealer in North Dakota is a deductible business expense.

Rev. Rul. 69–605

Advice has been requested whether an excise tax imposed by a city upon the proceeds from gross sales of liquor by a "nonprofit" liquor dealer in North Dakota, is deductible for Federal income tax purposes.

"Nonprofit" liquor dealerships were first established in North Dakota after the State Supreme Court determined that it was unconstitutional for the State or any political subdivision thereof to engage in the sale, at wholesale or retail, of alcoholic beverages. Private citizens in various communities throughout the State have organized these dealerships.

The "nonprofit" liquor dealership under consideration seeks to make a profit but, instead of accumulating its earnings or paying them out as dividends, remits its net income annually to the government of the city in which it is located.

In 1963 North Dakota enacted legislation enabling local governments to levy an excise tax, subject to certain limitations, upon the proceeds from gross sales of liquor by "nonprofit" liquor dealerships. No such dealership may be taxed by any city or village in which there is located any other liquor dealership whether or not such other dealership is operated for profit. (Sec-

tion 40–05–02.2 of the North Dakota Civil Code.)

The city in which this "nonprofit" liquor dealership is located levied an excise tax computed on a fixed percentage of the proceeds from the gross sales of liquor by the dealership.

Section 164(a) of the Internal Revenue Code of 1954 provides, in part, that State and local taxes paid or accrued during the taxable year are deductible as a tax provided they are incurred in carrying on a trade or business or in the production of income.

It is held that the local excise tax paid or accrued on the proceeds from gross sales of the described "nonprofit" liquor dealer is deductible under section 164(a) of the Code as a tax incurred in carrying on a trade or business.

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26 CFR 1.164–1: Deduction for taxes.

Whether depositors of the national banks in Rhode Island may deduct the State tax assessed on their deposits where banks elect to pay such tax. See Rev. Rul. 69–497, page 23.

Section 165.—Losses

26 CFR 1.165–1: Losses.
(Also Section 166; 1.166–1.)

Loss of accounts receivable by a United States citizen whose business was expropriated by the Cuban government is deductible as a business loss under section 165(c)(1) of the Code; Revenue Ruling 62–197 modified.

Rev. Rul. 69–498

Reconsideration has been given to that part of factual situation (4) of Revenue Ruling 62–197, C.B. 1962–2, 66, which deals with a loss of accounts receivable by a United States citizen whose retail store, located in Cuba, was intervened in during 1959 by the Cuban Government. The assets of the business, including the accounts receivable, were expropriated by Cuban decree in 1960.

It was held, in part, under factual situation (4) of Revenue Ruling 62–197 that the loss of the accounts receivable in question was deductible under section 166(a) of the Internal Revenue Code of 1954 as a wholly worthless debt.

In *Emil Stern* v. *Commissioner,* 5 B.T.A. 89 (1926), acquiescence, C.B. VIII–1, 43 (1929), certain debts owing the taxpayer were seized by the German Alien Property Custodian, the effect of which vested possession and title to the property in the Custodian. In concluding that the expropriation entitled the taxpayer to a deduction for a "loss sustained," and not to a deduction for a "debt ascertained to be worthless," the court reasoned that the debtor was solvent, and that while uncollectible by the taxpayer, the debts did possess value and were collectible by the new owner. The court further reasoned, in substance, that since the taxpayer had been entirely divested of his property by the foreign government, he had sustained a loss. See also *Hector Fezandie, Executor* v. *Commissioner,* 12 B.T.A. 1325 (1928).

Factual situation (4) of Revenue Ruling 62–197 indicates that the Cuban Government intervened in and expropriated the assets of the taxpayer's business. While such seizure divested the taxpayer of his property and presumably rendered the accounts receivable uncollectible by the taxpayer, nothing in factual situation (4) of Revenue Ruling 62–197 indicates that the debtors were insolvent or that the accounts receivable were without value. In the absence of such evidence, the taxpayer is not entitled to a deduction for a worthless debt under section 166(a) of the Code. However, since he has sustained a loss in respect to the unrealized receivables, taxpayer is entitled to a deduction pursuant to the provisions of section 165(c)(1) of the Code relating to losses incurred by an individual in a trade or business.

Accordingly, the holding with respect to factual situation (4) of Revenue Ruling 62–197, insofar as it relates to accounts receivable, is hereby modified to hold that such loss sustained in respect to the accounts receivable is deductible under section 165(c)(1) of the Code.

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26 CFR 1.165–1: Losses.

Whether the losses sustained by taxpayers who bought stock from a securities corporation that subsequently became bankrupt and did not deliver the stock, are deductible under section 165 of the Code as losses in a transaction entered into for profit, or under section 166 as bad debts. See Rev. Rul. 69–458, page 33.

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26 CFR 1.165–11: Election in respect of losses attributable to a disaster.

The Revenue Service lists the "major disaster" areas in which losses during 1969 qualify for special tax treatment under section 165(h) of the Code.

Rev. Rul. 69–644

Under section 165(h) of the Internal Revenue Code of 1954, a taxpayer who suffers a disaster loss between the close of the taxable year and the due date prescribed by law for filing the income tax return for the taxable year, may elect to take his deduction for that loss on his Federal income tax return for the taxable year preceding the year in which the disaster occurred, provided the loss is one that occurred in an area determined by the President of the United States to warrant Federal disaster assistance.

Revenue Ruling 64–332, C.B. 1964–2, 59, sets forth the procedures for making an election with respect to such losses.

The President has determined that various areas in the States listed below were adversely affected by natural disasters of sufficient severity occurring during 1969 to warrant disaster assistance.

Disaster area, 1969	Type of disaster	Disaster beginning on or about
Alabama	Hurricane Camille	August 17, 1969.
Alaska	Heavy rains and landslide	November 28, 1969.
Arkansas	Severe storms and flooding	January 28, 1969.
California	Severe storms and flooding	January 17, 1969.
	Flooding	March 11, 1969.
	Severe storms and flooding	December 17, 1969
Colorado	Flooding	May 4, 1969.
Illinois	Flooding	April 15, 1969.
	Heavy rains and flooding	June 29, 1969.
Iowa	Flooding	March 20, 1969.
	Severe storms, heavy rains and flooding.	June 25, 1969.
Kansas	Tornadoes, severe storms, and flooding.	June 21, 1969.
Kentucky	Severe storms and flooding	June 22, 1969.
	Heavy snows, rains, and flooding.	December 30, 1969
Louisiana	Hurricane Camille	August 17, 1969.
Maine	Severe storms, ice jams, and flooding.	December 26, 1969
Minnesota	Flooding	March 22, 1969.
	Heavy rains and flooding	June 25, 1969.
Mississippi	Hurricane Camille	August 17, 1969.
Nevada	Flooding	March 28, 1969.
New York	Heavy rains and flooding	July 27, 1969.
North Dakota	Flooding	April 7, 1969.
Ohio	Tornadoes, severe storms, and flooding.	July 4, 1969.
Pennsylvania	Severe storms and flooding	July 27, 1969.
South Dakota	Flooding	April 2, 1969.
Tennessee	Severe storms and flooding	June 23, 1969.
Vermont	Severe storm and flooding	July 29, 1969.
Virginia	Severe storms and flooding	August 19, 1969.
West Virginia	Severe storms and flooding	August 20, 1969.
	Severe storms and flooding	September 5, 1969.
Wisconsin	Flooding	March 25, 1969.
	Severe storms and flooding	June 29, 1969.

Notices of any additional declarations of major disaster areas will be announced currently in the Internal Revenue Bulletin.

Section 166.—Bad Debts

26 CFR 1.166–1: Bad debts.

A taxpayer may adopt the reserve method of accounting for bad debts for the first taxable year in which he is entitled to a bad debt deduction without prior permission of the Commissioner.

Rev. Rul. 69–548

The taxpayer, a manufacturer, has been in business for a period of approximately twelve years. During this period its products have been sold to retail outlets and there has never been a bad debt to be written off, or outstanding accounts receivable with respect to which there was any question as to collectibility. However, during the current taxable year the taxpayer for the first time has several accounts with respect to which it is reasonable to establish a reserve for bad debts.

Held, under the stated facts, the taxpayer may adopt the reserve method of accounting for bad debts for its current taxable year without the prior permission of the Commissioner under section 166(c) of the Internal Revenue Code of 1954 and the Income Tax Regulations prescribed thereunder at section 1.166–1(b), since the current year is the first taxable year for which it is entitled to a bad debt deduction. This taxable year is the first year when the taxpayer had accounts receivable with respect to which it is reasonable to expect that it might sustain a bad debt.

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26 CFR 1.166–1: Bad debts.

Deductibility of an amount equal to a portion of the Federal estate tax for purposes of computing a legatee's taxable income. See Rev. Rul. 69–411, page 177.

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26 CFR 1.166–1: Bad debts.

Confiscation of accounts receivable in Cuba by the Government of Cuba. See Rev. Rul. 69–498, page 31.

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26 CFR 1.166–4: Reserve for bad debts.

Revenue Ruling 54–597, relating to additions to reserves for bad debts by banks, is superseded.

Rev. Rul. 69–533

Revenue Ruling 65–92, C.B. 1965–1, 112, effective for taxable years ending after December 31, 1964, provides a uniform percentage for computing annual additions to reserve for bad debts by banks. Revenue Ruling 65–92 superseded both Mimeograph 6209, C.B. 1947–2, 26, and Revenue Ruling 54–148, C.B. 1954–1, 60. It follows that Revenue Ruling 54–597, C.B. 1954–2, 90, amplifying Mimeograph 6209 and Revenue Ruling 54–148, was likewise superseded, even though not specifically so stated in Revenue Ruling 65–92. Accordingly, Revenue Ruling 54–597 is hereby superseded.

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26 CFR 1.166–5: Nonbusiness debts.

A nonbusiness bad debt deduction is allowable for unrecoverable deposits made for the construction of a residence when the construction company becomes insolvent and fails to perform under the contract.

Rev. Rul. 69–457

An individual taxpayer made deposits toward the purchase of a personal residence that was to be built by a con-

struction company under terms of a contract. The company became insolvent and discontinued business without beginning construction of the residence. The taxpayer was unable to recover his deposits.

Held, the taxpayer is entitled to a nonbusiness bad debt deduction for the taxable year in which the debt became worthless. When the taxpayer's right under the contract for the delivery of the house became unenforceable, his claim against the construction company became a right for repayment of money and a bona fide debtor-creditor relationship was, by operation of law, created within the meaning of section 1.166–1(c) of the Income Tax Regulations.

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26 CFR 1.166–5: Nonbusiness debts. (Also Section 165; 1.165–1.)

Losses sustained on purchases of undelivered stock from a securities corporation that subsequently becomes bankrupt are deductible as short-term capital losses under the nonbusiness bad debt provisions of section 166 of the Code.

Rev. Rul. 69–458

Advice has been requested as to what type of loss was sustained, and when it was deductible, by individual taxpayers who bought stock from a securities corporation that subsequently became bankrupt and did not deliver the stock.

The securities corporation represented to the individual taxpayer purchasers that the stock in question was being sold from its own inventory. Subsequently, it was discovered that the securities corporation did not have sufficient shares in its inventory to fill the orders, and a petition in bankruptcy was filed on behalf of the securities corporation. The representations with respect to the stock were not made with any intent to defraud.

The purchasers paid cash to the corporation to fulfill their obligations in the transaction. None of the purchasers was a dealer in securities. The stock was never delivered to the purchasers by the corporation and no refund of the money was made.

Section 166(d)(1) of the Internal Revenue Code of 1954 provides that nonbusiness bad debts are deductible as short term capital losses in the year in which such nonbusiness bad debts become worthless. Section 166(d)(2) of the Code defines a nonbusiness bad debt as a debt other than (1) a debt created or acquired in connection with the taxpayer's trade or business, or (2) a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business.

However, as provided in section 1.166–1(c) of the Income Tax Regulations, only a bona fide debt qualifies for purposes of section 166. A bona fide debt is defined in that section of the regulations as a debt that arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money. A debt can be created by a contract or by operation of law. *Birdsboro Steel Foundry & Machine Co.* v. *United States,* 3 F. Supp. 640 (1933).

Section 165(c) of the Code provides, in effect, that losses incurred by individuals in a trade or business or in a transaction entered into for profit are deductible in full. However, section 165(f) of the Code provides that losses from the sale or exchange of capital assets are allowed only to the extent allowed in sections 1211 and 1212.

The taxpayers in this case come within the literal language of section 165(c)(2) of the Code inasmuch as their intent was to make a profit. Likewise, all of the taxpayers come within the literal language of section 166 of the Code. When their right under the contract for the delivery of the stock became unenforceable, their claim against the securities corporation became a right for repayment of money and a bona fide debtor-creditor relationship was, by operation of law, created within the meaning of section 1.166–1(c) of the regulations.

The Supreme Court of the United States held in *Spring City Foundry Co.* v. *Commissioner,* 292 U.S. 182 (1933), Ct. D. 829, C.B. XIII–1, 281 (1934), that the loss provisions and the bad debt provisions of the tax law are mutually exclusive; and that a transaction coming within the literal language of both the loss provisions and the bad debt provisions must be treated as a bad debt. The Court stated:

> The making of the specific provision as to debts indicates that these were to be considered as a special class and that losses on debts were not to be regarded as falling under the preceding general provision [relating to loss deductions]. What was excluded from deduction under [the provision for deducting bad debts] can not be regarded as allowed under [the provision for deducting losses] * * *

Therefore, the losses sustained by the taxpayers who bought stock from the securities corporation that subsequently became bankrupt and did not deliver the stock, are controlled by the bad debt provisions set out in section 166 of the Code. The taxpayers are entitled to deduct these losses as short term capital losses, under the nonbusiness bad debt provisions of section 166 of the Code, in the taxable year in which the debts became worthless.

Section 167.—Depreciation

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

The cost allocated to earthen watering tanks or "ponds" having an indeterminate life, constructed by prior owners on land purchased and leased to ranchers, is neither recoverable through depreciation nor deductible as a soil and water conservation expenditure.

Rev. Rul. 69–606

Advice has been requested whether, under the circumstances described below, depreciation is allowable on certain earthen tanks (sometimes called "ponds") on land purchased by a taxpayer.

The taxpayer is engaged in the leasing of land to ranchers for a fixed fee (not based on production) for raising livestock. The taxpayer does not participate in the management of the land

or the raising of the livestock. For use in its leasing business, the taxpayer purchased three large parcels of land, formerly ranches, upon which there were several earthen tanks or ponds used for watering livestock.

At the time of purchase by the taxpayer, the earthen tanks or ponds had been in use by the former owners or lessees for various periods of time and contained varying amounts of sediment. The earthen tanks or ponds were of various sizes, having water storage capacities of from 5,000 to over 20,000 cubic feet. They were originally constructed by removing earth to form an excavation or pit, some with earthen dams, forming a reservoir to impound and store the surface water for livestock use much like a natural pond.

The taxpayer desires to allocate each ranch's cost between land and improvements, including the earthen tanks or ponds, on the basis of the fair market value of the assets involved, and to depreciate the improvements over the estimated useful life of such improvements.

The taxpayer has not constructed any earthen tanks or ponds itself, nor has it cleaned out any of the existing ones. The taxpayer states that the average earthen tank or pond has a useful life of 20 to 25 years before sedimentation makes it useless. However, the taxpayer also states that the estimated life of each tank or pond will vary greatly due to many factors such as variation in soil, size of watershed, amount of protective vegetable covering, rainfall intensity, slope of terrain, and the quality of work involved in construction of the tank or pond. On smaller tanks or ponds of less than 5,000 cubic yards capacity, it is possible to use dragline equipment to clear sediment from the tank or pond, but on larger tanks or ponds, suitable equipment is not available to clean them out and it is more economical to construct a new tank or pond.

The taxpayer did not furnish any data that would establish any reasonable estimate of the useful lives of the earthen tanks or ponds in the instant case. The tanks or ponds continue in use for indefinite periods.

Section 167 of the Internal Revenue Code of 1954 allows as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of (1) property used in the trade or business, or (2) property held for the production of income.

Section 1.167(a)–1 of the Income Tax Regulations in defining what constitutes a reasonable allowance for depreciation states that the amounts of depreciation set aside, plus the salvage value, will at the end of the estimated *useful life* of the depreciable property equal the cost or other basis of the property.

Section 1.167(a)–2 of the regulations provides in part that the depreciation allowance in the case of tangible property applies only to that part of the property that is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence. The allowance does not apply to land, apart from the 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 that 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 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 because, in the unsupported opinion of the taxpayer, the intangible asset has a limited useful life.

Whether an asset is depreciable for Federal income tax purposes depends upon the determination that the asset is actually exhausting, and that such exhaustion is susceptible of measurement. *General Equipment Co.* v. *Commissioner*, 2 B.T.A., 804 (1925).

It is held that, on the facts of this case, the taxpayer's earthen tanks or ponds have indeterminable useful lives that are not reasonably susceptible of measurement and are, therefore, not depreciable.

Section 175 of the Code allows a taxpayer engaged in farming to elect to deduct certain expenditures (*not deductible* or depreciable *under any other section of the Code*) that are paid or incurred by him during the taxable year for soil and water conservation purposes with respect to land used in farming, such as the movement of earth (including the construction of channels, ditches, *earthen dams,* water courses, and *ponds*). This deduction is allowable only to taxpayers engaged in the business of farming. A taxpayer is engaged in the business or farming if he cultivates, operates, or manages a farm for gain or profit, either as owner or tenant.

In the instant case the taxpayer is not engaged in the business of farming within the meaning of section 175 of the Code. Furthermore, the expenditures for the construction of the earthen tanks or ponds were not paid or incurred by the taxpayer during the taxable year. Accordingly, no deduction is available to the taxpayer under that section.

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

Amortization of the costs of master recordings. See Rev. Rul. 69–475, page 40.

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

Costs incurred under the retirement method of accounting for the rearrangement and reconstruction of a railroad company's classification yard. See Rev. Rul. 69–476, page 40.

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

Treatment of cost of tires and tubes purchased with highway construction equipment. See Rev. Rul. 69–560, page 25.

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26 CFR 1.167(a)–5: Apportionment of basis.

Allocation of the total cost of a going coal mining enterprise, purchased by the taxpayer, to its various assets for the purpose of determining the basis of each asset. See Rev. Rul. 69–539, page 141.

26 CFR 1.167(a)–8: Retirements. (Also Section 446; 1.446–1.)

Recovered and rebuilt parts accounted for through a material and supplies account are valued at fair market value at time of recovery plus cost of rebuilding.

Rev. Rul. 69–370

Advice has been requested concerning the proper values, for Federal income tax purposes of certain rebuilt parts, under the circumstances described below.

Used parts are recovered by the taxpayer, a railroad company, from its equipment being repaired, and from "normal" and "abnormal" retirements of its equipment. Such recovered parts are restored to good operating condition by the taxpayer in its repair shop. The rebuilt parts are placed in the materials and supplies inventory.

Later, as these parts are needed they are taken from the materials and supplies inventory and installed by the taxpayer in its equipment. The equipment from which the parts are taken and in which they are installed is depreciable property accounted for in a multiple asset account with the depreciation rate based on average expected useful life.

The taxpayer has consistently accounted for its recovered parts (before they are rebuilt) by charging its materials and supplies account with an amount equal to the current cost of similar new parts. At the same time that amount is: (1) credited to operating expense, if the parts recovered were from the repair of operating equipment, (2) credited to the depreciation reserve account, if the parts recovered were from normal retirements, or (3) used as a credit to the gain or loss on equipment abnormally retired and disposed of. The labor, material, and overhead costs incurred by the taxpayer to rebuild these parts, irrespective of their source of recovery, are charged to operating expense.

The taxpayer has shown that the fair market value of its recovered parts (before they are rebuilt), plus the cost of rebuilding the parts, has consistently been substantially less than the value used (the current cost of similar new parts) in accounting for such parts in the past.

Revenue Ruling 67–145, C.B. 1967–1, 54, holds in part that railroads using the "retirement method" of accounting for depreciation for their track account assets must value their recovered track materials at their fair market values at the time such materials are retired and transferred to supplies or scrap accounts (without disposition). Although the "retirement method" was being used by the railroads referred to in Revenue Ruling 67–145 (whereas in the instant case depreciable assets are accounted for using an average depreciation rate), that Revenue Ruling makes it clear that irrespective of the method of accounting used, the concept of salvage value is the same under the regulations.

Accordingly, it is held that the taxpayer's parts that were recovered and rebuilt, and accounted for through the materials and supplies account, are to be valued at an amount equal to the fair market value of the parts at the time they were recovered, plus the costs incurred in rebuilding those parts. However, a change with regard to the valuation of such parts under these circumstances is a change in method of accounting within the meaning of section 446 of the Code.

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26 CFR 1.167(e)–1: Change in method.

Procedure for changing certain methods of computing depreciation. See Rev. Proc. 69–29, page 311.

Section 170.—Charitable, Etc., Contributions and Gifts

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

Money donated to a State by an individual to defray expenses of hosting a governors' conference is deductible as a charitable contribution but the value of merchandise presented to the visiting governors as personal mementos is not deductible.

Rev. Rul. 69–459

Advice has been requested whether money and the value of merchandise given by an individual in connection with a governors' conference held in State *R* under the circumstances described below are deductible as charitable contributions under section 170 of the Internal Revenue Code of 1954.

State *R*, as host, was in complete charge of arrangements for a governors' conference held in *R*. The governors' conference consisted of a series of daily meetings of governors of several States for the purpose of discussion, exchanges of views, and possible agreements on various administrative problems of the several States. The entire cost of the conference was approximately 75*x* dollars. Fifty *x* dollars of this cost was appropriated by the General Assembly of State *R*, and 25*x* dollars in money was solicited and obtained from private sources within the State. All financial arrangements were subject to audit by the State Auditor. In addition, certain manufacturers were invited to give gifts of merchandise as personal mementos of the conference to the visiting governors and their wives.

Under this arrangement, *A*, an individual, gave State *R* money, which was used to defray expenses directly incurred in connection with the governors' conference. In addition, *A* gave directly to each of the governors and their wives individual gifts of merchandise as personal mementos of their visit to State *R* and the governors' conference.

Section 170(a) of the Code provides for the deduction, within certain limitations, of any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year.

Under section 170(c)(1) of the Code, the term charitable contribution is defined, in part, as including a contribution or gift to or for the use of a State, but only if the contribution or gift is made for exclusively public purposes.

Money expended by a State in "hosting" a governors' conference is for an exclusively public purpose. However, merchandise given by an individual manufacturer to each of the governors and their wives as personal mementos of their visit to State *R* and attendance at the governors' conference were not gifts given to or for the use of State *R* and were not for an exclusively public purpose.

Accordingly, it is held that the money given by *A* to State *R* to defray the expenses incurred directly in connection with the governors' conference is deductible by *A* as a charitable contribution under section 170 of the Code, subject to the limitations prescribed in that section. However, the value of the merchandise given by *A* to each of the governors and their wives as personal mementos of their visit to State *R* and the governors' conference held there is not deductible by *A* as a charitable contribution.

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

The additional ten-percent charitable deduction is applicable to contributions made to an organization whose only function is to conduct classes for eight weeks each summer during which it maintains a regular faculty and curriculum with a regularly enrolled body of students.

Rev. Rul. 69–492

Advice has been requested whether the organization described below is an educational organization of the type described in section 170(b)(1)(A)(ii) of the Internal Revenue Code of 1954 so that contributions to it are subject to the special limitation provision of section 170(b)(1)(A) of the Code.

The organization's only function is conducting a summer training school with a curriculum built around a core of theological studies analogous to that of a theological seminary. Classes are taught on a graduate level by college and seminary professors and the school is chartered by the State and empowered to grant Master of Arts degrees. The school has a regularly enrolled body of students and it meets for approximately eight weeks each summer, using the campus facilities of another school. It does not hold classes during the remainder of the year. The course of study leading to the degree is made up of 30 semester hours of academic work consisting of eight semester hours each summer together with three hours of prescribed winter work each intervening winter. The degree is awarded to qualified students who successfully pass a comprehensive examination based on three summers of full-time resident study. Candidates for the degree must have received a Bachelor's degree in arts or science from an approved college or university.

The organization has previously been determined to be exempt from Federal income tax under section 501(c)(3) of the Code, and contributions made to it have previously been determined to be deductible by individual donors to the extent of the general limitation of 20 percent of adjusted gross income as provided by section 170(b)(1)(B) of the Code.

Section 170(a)(1) of the Code provides that there shall be allowed as a deduction any charitable contribution payment of which is made within the taxable year.

Section 170(b)(1)(A) of the Code provides for an additional deduction not to exceed 10 percent of an individual's adjusted gross income for contributions made to certain organizations, including an "educational" organization described in section 170(b)(1)(A)(ii) of the Code.

Section 1.170–2(b)(3)(i) of the Income Tax Regulations provides that an "educational organization" within the meaning of section 170(b)(1)(A) of the Code is one whose primary function is the presentation of formal instruction and which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

Although the organization in the instant case conducts classes for only eight weeks each summer, it is, nevertheless, an educational organization within the meaning of section 170(b)(1)(A)(ii) of the Code since, during the eight weeks of operation, (1) its primary function is the presentation of formal instruction, (2) it normally maintains a regular faculty and curriculum, and (3) it normally has a regularly enrolled body of pupils and students in attendance at the place where its educational activities are regularly carried on.

Accordingly, the special limitation provision of section 170(b)(1)(A) of the Code, allowing an additional deduction not exceeding 10 percent of an individual's adjusted gross income, is applicable to contributions made by individual donors to the instant organization.

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

The fair market value of property normally sold by a taxpayer that is contributed to a charitable organization is its lowest usual selling price not reduced by a discount for prompt payment offered to customers.

Rev. Rul. 69–514

The taxpayer made a charitable contribution, as defined in section 170(c) of the Internal Revenue Code of 1954, of property of the type that he sells in the course of his business. It is the taxpayer's business practice to allow a two percent discount for prompt payment on property sold to his customers. The discount is not granted if the customer does not pay within the time allotted. In fact and in actual operation, the discount is solely a discount for prompt payment as distinguished from either a quantity discount or a trade discount.

Section 1.170–1(c)(1) of the Income Tax Regulations states that if a contribution is made in property other than money, the amount of the deduc-

tion allowable under section 170 of the Code on account of the contribution is ordinarily measured by the fair market value of the property at the time of the contribution. The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. If the contribution is made in property of a type which the taxpayer sells in the course of his business, the fair market value is the price which the taxpayer would have received if he had sold the contributed property in the lowest usual market in which he customarily sells, at the time and place of the contribution (and in the case of a contribution of goods in quantity, in the quantity contributed).

Held, under the circumstances of this case, for purposes of determining the fair market value of the property contributed to the charitable organization, the lowest usual selling price of the property is not to be reduced by the cash discount allowable for prompt payment.

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

Whether contributions to a college fraternity are deductible. See Rev. Rul. 69–573, page 125.

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

Unreimbursed out-of-pocket expenses incurred by a taxpayer participating in a program conducted by a charitable organization to assist unmarried pregnant women are deductible under section 170 of the Code.

Rev. Rul. 69–473

Advice has been requested whether out-of-pocket expenses incurred by a taxpayer under the circumstances described below, are deductible as charitable contributions.

A charitable organization of the type described in section 170(c)(2) of the Internal Revenue Code of 1954 conducts a charitable program consisting primarily of rendering assistance to indigent unmarried pregnant women. As part of this program, during the middle months of their pregnancy, these women are placed in the homes of families who volunteer their assistance to the organization. The participating families are selected only after they have been investigated and approved by the organization. In addition the progress of each woman while living with the family is supervised by the organization's staff. The organization requires that the families selected provide the women with living quarters that will insure their privacy, and furnish them with a proper diet, clothing, and a small weekly allowance. The woman is to be treated as a member of the family household and as such is expected, when capable, to assist in such household chores as washing dishes, dusting, and cooking but the organization stresses to the family that the role of the woman is not that of an employee. The weekly allowance is intended to permit the woman to exercise her independent judgment in spending or saving.

The taxpayers, husband and wife, participated in the program of the charitable organization by taking a woman, not related to them, into their home for a two-month period. As required by the organization the husband and wife paid for her food and clothing and gave her a small weekly allowance. They were not reimbursed for these expenditures.

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 Code, 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, the charitable organization assumed the responsibility of caring for the unmarried pregnant woman. When the taxpayers opened their home for the woman referred to them by the charitable organization they were aiding the organization in carrying out its charitable activities and the out-of-pocket expenses incurred by them are regarded as contributions or gifts for the use of the charitable organization.

Accordingly, since the out-of-pocket expenses incurred by the taxpayers for the food and clothing and the weekly allowance are directly connected with and solely attributable to the rendition of gratuitious services to the charitable organization described in section 170(c)(2) of the Code, it is held that these amounts are deductible by the taxpayers as charitable contributions in the manner and to the extent provided by section 170 of the Code in computing taxable income. However, amounts the taxpayers would have expended had the woman not been in their household (such as the cost of rent, utilities, taxes, insurance, and similar items) are not charitable contributions under section 170 of the Code.

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26 CFR 1.170–2: Charitable deductions by individuals; limitations.
(Also Section 162; 1.162–2.)

Automobile expenses incurred by an ordained minister while rendering services without compensation are deductible as a charitable contribution.

Rev. Rul. 69–645

Advice has been requested whether a taxpayer may deduct as a business expense or as a charitable contribution his automobile expenses incurred under the circumstances described below.

The taxpayer serves without compensation as an ordained minister of a church, which is an organization described in section 170(c) of the Internal Revenue Code of 1954. He spends approximately 20 hours per week fulfilling his prescribed duties and frequently uses his automobile in performing these duties. The work performed by him is under the direction of his superiors in the organizational structure of the church. He is subject

to removal by the same authorities who are authorized to appoint him.

His responsibilities include presiding over the church in the geographic area assigned to him, planning and conducting sacerdotal functions and meetings of the church within that geographic area (including religious worship), attending district meetings as needed (to be given instruction, assignments, and counsel from higher authorities), planning and conducting weddings and funerals, and interviewing and recommending members of the church eligible for missionary work, baptisms, etc.

Section 162(a) of the Code 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 such cost is incurred in his trade or business.

Section 170 of the Code provides in part that in computing taxable income an individual may deduct, subject to certain limitations, charitable contributions or gifts payment of which is made within the taxable year to or for the use of certain organizations, including a church or a convention or association of churches.

Whether the taxpayer is engaged in a "trade or business" is determined under section 162 of the Code. A "trade or business" is generally defined as that branch of activities wherein an individual expends his usual everyday efforts to gain a livelihood.

The case of *Hugenia Doggett* v. *David Burnet*, 65 F. 2d 191 (1933), concerned the question of whether the taxpayer was, in fact, engaged in a "trade or business." In deciding that question, the court stated that the "proper test [of whether an individual is carrying on a trade or business] is not the reasonableness of the taxpayer's belief that a profit will be realized, but whether it is entered into and carried on in good faith and for the purpose of making a profit, or in the belief that a profit can be realized thereon, and that it is not conducted merely for pleasure, exhibition, or social diversion."

Since the taxpayer in the instant case undertook his duties with no expectation of receiving compensation, he did not undertake the position for the purpose of making a profit or in the belief that a profit could be realized from it. Therefore, the taxpayer is not engaged in a "trade or business" for purposes of section 162(a) of the Code.

Accordingly, the taxpayer is not entitled to deduct as business expenses under section 162(a) of the Code his automobile expenses incurred while carrying out his duties and obligations as a minister. However, he is entitled to a deduction for these expenses as a charitable contribution under section 170(c) of the Code provided he itemizes his deductions on his tax return. The taxpayer may, within the limitations of section 170(c) of the Code, deduct his actual, out-of-pocket expenses incurred while rendering his services as a minister. However, see Revenue Procedure 64–15, C.B. 1964–1 (Part 1), 676, which provides that the Internal Revenue Service will accept a standard mileage rate of five cents per mile as representative of the cost of operating an automobile for charitable purposes.

Section 172.—Net Operating Loss Deduction

26 CFR 1.172–1: Net operating loss deduction.

Whether a net operating loss incurred in a year governed by the consolidated return regulations applicable to taxable years beginning after December 31, 1965, can be carried back to a separate return year of a member of the group commencing prior to December 31, 1965. See Rev. Rul. 69–623, page 171.

26 CFR 1.172–4: Net operating loss carrybacks and net operating loss carryovers.

A corporation cannot offset its first year's net loss against the net income of an acquired sole proprietorship for which it assumed the tax liability of the previous year, even though the loss and income arose from the same business; A.R.R. 1597 superseded.

Rev. Rul. 69–515 [1]

A corporation acquired and continued the business previosuly conducted by a sole proprietor. The corporation assumed and paid the Federal income tax liability of the prior year assessed against the sole proprietor arising from the income of the same business. The new corporation suffered a net loss during its first year of operation and claimed the right to offset such loss against the income of the predecessor business that was conducted in the prior year as a sole proprietorship and the right to a refund of any taxes paid by it in excess of those shown to be due upon giving effect to such offset of losses.

Held, the corporation cannot offset its loss against the income of its predecessor, a sole proprietorship, and therefore no refund is allowable to the corporation.

A.R.R. 1597, C.B. II–1, 33 (1923) is hereby superseded since the position stated therein is restated under current statute and regulations in this Revenue Ruling.

Section 174.—Research and Experimental Expenditures

26 CFR 1.174–1: Research and experimental expenditures; in general.

Contributions made by an airline to an aircraft manufacturer to help defray the cost of designing, developing, fabricating, and testing a supersonic transport prototype aircraft are research and experimental expenditures under section 174 of the Code.

Rev. Rul. 69–484

The Federal Aviation Agency (FAA) entered into an agreement with an aircraft manufacturer pursuant to

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

which the aircraft manufacturer will design, develop, fabricate, and test two supersonic transport prototype aircraft (SST) and perform other SST research and development work. The aircraft manufacturer and the FAA will each bear a portion of the cost thereof. In order to assure that the development phase of the SST aircraft program will proceed in a timely manner, the FAA has invited the taxpayer, who is engaged in the business of air transportation, and other airlines to participate in the SST aircraft program by making payments to the aircraft manufacturer to defray a portion of the research and development costs. The payments are not to be applied to the purchase price of any aircraft, there is no right to a refund, and the taxpayer receives no benefit other than that stated below.

The taxpayer, recognizing that the SST research and development work could ultimately benefit it by making such an aircraft available, entered into an agreement (characterized as the Group 1 Airline Contribution Agreement) with the aircraft manufacturer under which it made payments to the manufacturer to be used, along with payments made by other airlines under similar agreements, by the manufacturer, solely for SST research and development work.

Held, the payments made by the taxpayer under the Group 1 Airline Contribution Agreement are research and experimental expenditures under section 174(a) of the Internal Revenue Code of 1954.

Part VII. Additional Itemized Deductions for Individuals

Section 213.—Medical, Dental, etc., Expenses

26 CFR 1.213–1: Medical, dental, etc., expenses.

The cost of maintaining a mentally retarded son in a specially selected home, to aid in his adjustment from institutional living to community living, qualifies as a medical expense; Revenue Ruling 58–481 superseded.

Rev. Rul. 69–499

Advice has been requested whether a taxpayer incurred an expense for "medical care" within the meaning of section 213 of the Internal Revenue Code of 1954, when he paid the cost of maintaining his mentally retarded dependent son in a specially selected home to aid his adjustment from life in a mental hosiptal to life in the community, following the recommendation of his psychiatrist.

The taxpayer's retarded son, age 24, had received treatment at a mental hospital over a period of six years. The psychiatrist in charge of the son's case believed that the retardate could make a successful adjustment from life in a mental hospital to life in the community if he were placed in a proper environment during the period of adjustment, and recommended that an attempt be made to accomplish this. Acting upon this recommendation, the taxpayer arranged for his son to live in a home that met all of the requirements specified by the doctor, namely:

(1) that the home be near the hospital;

(2) that there be in the home both husband and wife who are emotionally stable;

(3) that the husband and wife be able and willing to care for and supervise the patient and to accept the doctor's professional recommendations regarding the manner in which they relate to the patient; and

(4) that there be no other patients or possible rivals for attention in the home.

There was no family relationship between the taxpayer and the persons in whose home the retardate son was to stay. The taxpayer paid a substantial amount to obtain the type of living accommodations for his son that the doctor prescribed.

Section 213(a) of the Internal Revenue Code of 1954 allows as a deduction expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent, subject to certain limitations.

Under section 213(e) of the Code, the term "medical care" means amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body; for transportation primarily for and essential to medical care; and for insurance covering medical care.

The cost of meals and lodging is a personal expense for which, under section 262 of the Code, no deduction is allowable except as otherwise expressly provided.

Section 1.213–1(e)(1)(v) of the Income Tax Regulations provides, in part, that the cost of in-patient hospital care, *including the cost of meals and lodging therein,* is an expenditure for medical care. The extent to which expenses for care in an institution other than a hospital constitute medical care is primarily a question of fact that depends upon the condition of the individual and the nature of the services he receives (rather than the nature of the institution). This section also provides that the care and supervision of a mentally retarded individual at an institution is within the meaning of the term "medical care."

For purposes of section 1.213–1(e)(1)(v) of the regulations a private establishment that is regularly engaged in providing the types of care or services outlined therein is considered an "institution." To be "regularly engaged" in providing medical care means that the persons who are providing the care are devoting a substantial portion of their time to providing such care and that they are providing the care in exchange for a consideration determined at arm's length. The care need not be provided as a profit-making venture; in fact, it may be provided to a charity patient for a nominal payment or no payment at all. Nevertheless, the determination of the amount of the charge must be made at arm's length. Inter-family ar-

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rangements are not normally considered to be at arm's length.

Where an individual is in an institution because his condition is such that the availability of medical care is a principal reason for his presence there, and meals and lodging are furnished as a necessary incident to such care, the entire amount paid for such institutional care, including meals and lodging furnished to the individual, is an expense for medical care. Section 1.213–1(e)(1)(v)(a) of the regulations.

Accordingly, the amounts paid by the taxpayer to maintain his mentally retarded son in the specially selected home in accordance with the recommendation of the psychiatrist in charge of the son's case, for the purpose of helping the son adjust from life in a mental hospital to life in the community, are expenses for medical care within the meaning of section 213 of the Code.

Revenue Ruling 58–481, C.B. 1958–2, 107, which relates to a somewhat similar factual situation and reaches a similar conclusion, is hereby superseded.

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26 CFR 1.213–1: Medical, dental, etc., expenses.

Amounts paid by a taxpayer for language training for his child to correct a condition caused by congenital damage to the brain are amounts paid for medical care under section 213 of the Code.

Rev. Rul. 69–607

Advice has been requested whether amounts paid by a taxpayer for language training for his child, to correct a condition known as dyslexia, are amounts paid for medical care within the meaning of section 213 of the Internal Revenue Code of 1954.

It was determined by recognized testing methods that the taxpayer's child was severely deficient in reading ability while his general intelligence was within the normal range for a child of his age. The child was given a comprehensive examination by a neurological pediatrician who identified the child's condition as dyslexia which in this case was caused by congenital damage to the brain, and recommended remedial reading courses to correct the condition.

The taxpayer arranged for the child to receive training from a teacher who was specially trained and qualified to teach remedial reading to mitigate the dyslectic condition. He was required to pay a specified fee for this instruction.

Section 213(a) of the Code allows as a deduction amounts paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent, subject to certain limitations.

The term "medical care" is defined, in part, in section 213(e)(1) of the Code as meaning 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."

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 are confined strictly to expenses incurred primarily for the prevention or alleviation of a physical or mental defect or illness.

Since the evaluation made by the medical specialist in the instant case established that the child's dyslexia in this case was caused by brain damage, the child has a "physical or mental defect or illness" within the meaning of section 1.213–1(e)(1)(ii) of the regulations.

Accordingly, the amounts paid by the taxpayer in this case for training for his child are amounts paid for medical care within the meaning of section 213 of the Code.

Section 217.—Moving Expenses

26 CFR 1.217–1: Deduction for moving expenses.

Deductibility of expenses incurred in obtaining passports in connection with the commencement of work by a taxpayer as an employee at a new principal place of work. See Rev. Rul. 69–425, page 16.

Part VIII. Special Deductions for Corporations

Section 243.—Dividends Received by Corporations

26 CFR 1.243–1: Deduction for dividends received by corporations.

Whether an election under section 243(b)(2) of the Code, to exclude qualifying dividends pursuant to the provisions of section 243(a)(3) of the Code will preclude the filing of a consolidated return. See Rev. Rul. 69–469, page 169.

Part IX. Items not Deductible

Section 263.—Capital Expenditures

26 CFR 1.263(a)–1: Capital expenditures; in general.
(Also Section 167; 1.167(a)–1.)

The costs of master recordings used for substantially more than one year to produce records must be capitalized and recovered through depreciation.

Rev. Rul. 69–475

A taxpayer is in the business of producing phonograph records for sale. It incurs costs in preparing master recordings that it uses in the manufacture of its records. Records are pressed as needed for current sale and it has been established that each master recording is used for substantially more than one year to produce records for sale.

Held, the costs incurred in preparing each master recording must be capitalized. Under the circumstances, such costs may be depreciated over the period during which it is estimated that the master recording will be used in producing records for sale.

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26 CFR 1.263(a)–1: Capital expenditures; in general.
(Also Section 167; 1.167(a)–1.)

Treatment of costs to rearrange and reconstruct a classification yard incurred by a railroad company using the "retirement method" of accounting for depreciation of its track account assets.

Rev. Rul. 69–476

Advice has been requested concerning the proper treatment, for Federal income tax purposes, of costs incurred by a railroad company to rearrange and reconstruct one of its railroad classification yards, under the circumstances described below.

The railroad company used the "retirement method" of accounting for depreciation for its track account assets. It retired, shifted, rearranged, and constructed tracks in one of its railroad classification yards to accommodate certain new electronic facilities. Before the yard was rearranged and reconstructed, it contained 200,000 feet of tracks including 150 turnouts. After the yard was rearranged and reconstructed, it contained 190,000 feet of tracks including 120 turnouts. In rearranging and reconstructing the yard, the railroad company removed (without replacing) 21,000 feet of tracks including 46 turnouts and constructed at different locations within the yard 11,000 feet of new tracks including 16 new turnouts. Both new and reusable materials were taken from the materials and supplies account and used in constructing the new tracks and turnouts. The balance of the existing tracks (179,000 feet including 104 turnouts) was shifted and rearranged, and remained substantially in the same location in the yard, with some new and recovered reusable track materials installed as replacements, some of which were permanent "improvements or betterments."

Section 263 of the Internal Revenue Code of 1954 provides, in part, that no deduction shall be allowed for any amounts paid out for permanent improvements or betterments made to increase the value of any property or estate.

Section 1.263(a)–1 of the Income Tax Regulations provides, in part, that except as otherwise provided in chapter 1 of the Code, no deduction shall be allowed for any amount paid out for permanent improvements or betterments made to increase the value of any property or estate or to adapt property to a new or different use.

Revenue Ruling 67–22 and Revenue Ruling 67–145, C.B. 1967–1, pages 52 and 54, respectively, describe the "retirement method" of accounting used by railroads generally for their track account assets. Under that method, where tracks, in whole or in part, are retired and removed without replacement, the basis, as reflected in the capital accounts, of the retired assets less the salvage value, should be charged to expense, and the cost of new tracks constructed should be capitalized.

Accordingly, in the instant case, under the "retirement method" of accounting for depreciation used by the railroad company for its track account assets, the adjusted basis and the removal costs of the 21,000 feet of tracks removed and not replaced, including the 46 turnouts, less the salvage value of the materials recovered, are deductible for Federal income tax purposes under section 167 of the Code. On the other hand, the costs incurred, including labor, for constructing the 11,000 feet of new tracks, including the 16 new turnouts, and the costs of the betterment portions of the replacements in the 179,000 feet of shifted and rearranged tracks, including the 104 turnouts, must be capitalized under section 263 of the Code. The remaining costs including all labor costs incurred for installing the replacements (less the capitalized betterment portions) in the 179,000 feet of shifted and rearranged tracks, including the 104 turnouts, less the salvage value of recovered materials of such replacements, are deductible under section 167 of the Code.

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26 CFR 1.263(a)–1: Capital expenditures, in general.

Whether payments to a registrar and transfer agent are deductible. See Rev. Rul. 69–615, page 26.

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26 CFR 1.263(a)–2: Examples of capital expenditures.

Whether a domestic corporation may deduct the cost of acquiring its own stock as a business expense. See Rev. Rul. 69–561, page 25.

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26 CFR 1.263(c)–1: Intangible drilling and development costs in the case of oil and gas wells.
(Also Section 612; 1.612–4.)

Certain costs incurred in drilling water injection wells necessary in the primary development of oil property are "intangible drilling and development costs" and may, at the taxpayer's option, be chargeable to capital or to expense.

Rev. Rul. 69–583

Advice has been requested whether certain costs incurred by a taxpayer in the drilling of water injection wells are "intangible drilling and development costs" that may, at the taxpayer's option, be chargeable to capital or deductible as an expense under the provisions of section 1.612–4 of the Income Tax Regulations under the circumstances described below.

The taxpayer owned an economic interest in all of the oil and gas contained in a certain "oil field." For several years the taxpayer, an operator, produced oil by natural flow from the central part of the field. The perimeter area of the field, however, could not be developed for production in commercial quantities in the absence of a water flooding program because the natural reservoir energy in this area was inadequate. The taxpayer developed the perimeter area of the field by setting up several "five-spot" well patterns. The taxpayer drilled water injection wells at four points with one oil producing well in the center. The injection of water supplemented the natural reservoir energy (pressure) causing oil to flow to the oil wells in the center of the "five-spot" patterns. Production from these oil wells was maintained by water flooding through the injection wells from a central plant.

Section 263(c) of the Internal Revenue Code of 1954, as implemented by section 1.612–4 of the regulations, provides that intangible drilling and development costs incurred by an operator "in the development of oil and

gas properties" may, at his option, be chargeable to capital or to expense. The regulations further provide that the option applies to all intangible expenditures "incident to and necessary for the drilling of wells and the preparation of wells for the production of oil and gas."

It is held that the intangible drilling and development costs incurred by the taxpayer in this case in drilling water injection wells are, at the taxpayer's option, chargeable to capital or deductible as expenses under section 1.612–4 of the regulations.

Section 270.—Limitation on Deductions Allowable to Individuals in Certain Cases

26 CFR 1.270–1: Limitation on deductions allowable to individuals in certain cases. (Also Section 1374; 1.1374–2.)

For purposes of the five-year requirement under section 270 of the Code, business losses covering three different time periods during one calendar year, in excess of $50,000 each, are aggregated and considered as losses in a single taxable year.

Rev. Rul. 69–584

Advice has been requested concerning the application of section 270 of the Internal Revenue Code of 1954 under the circumstances described below.

The taxpayer organized a corporation to operate a business of horse breeding. For its first taxable year beginning February 1, 1963, and ended January 31, 1964, the corporation elected to be treated as a small business corporation pursuant to the provisions of Subchapter S of Chapter 1 of the Code. The taxpayer was the sole shareholder and the election remained in effect throughout the existence of the corporation.

The corporation incurred net operating losses in excess of $50,000 in each of its taxable years including the short taxable year from February 1, 1967, to October 26, 1967, when it was liquidated. The corporation transferred all of its assets and liabilities to the taxpayer, its sole shareholder, and he continued to operate the business as a sole proprietorship. A loss in excess of $50,000 was incurred by the taxpayer from the operation of the business from October 27, 1967, through December 31, 1967.

The taxpayer computed his taxable income and filed his individual income tax return on the calendar year basis and deducted the losses sustained by the electing small business corporation since his adjusted basis in the stock of the corporation was sufficient to absorb the losses.

As a result of the above-described transactions, the taxpayer reported three losses each in excess of $50,000 on his 1967 individual income tax return. These losses represent the losses (1) from the operation of the corporation for the taxable year ended January 31, 1967, (2) from the operation of the corporation for the period of February 1, 1967, to October 26, 1967, and (3) from the operation of the business as a sole proprietorship from October 27, 1967, through December 31, 1967.

Section 270(a) of the Code provides, in part, that if the deductions allowed to an individual and attributable to a trade or business carried on by him for *five consecutive taxable years* have, in each of these years, exceeded by more than $50,000 the gross income from the trade or business, the taxable income of the individual for each of these years will be recomputed. For the purposes of the recomputation in the case of any such taxable year, the deductions will be allowed only to the extent of $50,000 plus the gross income attributable to the trade or business, except that the net operating loss deduction, to the extent attributable to the trade or business, will not be allowed.

Section 1.270–1(a)(4) of the Income Tax Regulations provides, in part, that if an individual conducts a particular type of business in one or more forms, such as a partnership, joint venture, or individual proprietorship, he must aggregate his share of the profits and losses from each business unit to determine the applicability of section 270 of the Code.

Section 1374(a) of the Code provides that a net operating loss of an electing small business corporation for any taxable year will be allowed as a deduction from gross income of the shareholders of the corporation.

Section 1.1374–2 of the regulations provides that a net operating loss will be considered as a deduction attributable to a trade or business carried on by the shareholder. Thus, it is an allowable deduction in computing adjusted gross income and is a deduction of the type on which a limitation may be imposed under section 270 of the Code.

The effect of section 1.1374–2 of the regulations is to treat a shareholder as if he were operating a business as an individual. Therefore, in computing the five consecutive taxable years, only the *shareholder's* taxable years are to be considered.

Accordingly, in the instant case, the taxpayer's calendar year 1967 is considered as only a single taxable year for purposes of section 270 of the Code even though he reported three losses in 1967 (each in excess of $50,000) covering three different time periods ending during that calendar year.

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.

A corporation's redemption of its stock from a retiring shareholder results in a constructive dividend to the remaining shareholder only if the redemption is in satisfaction of the remaining shareholder's primary and unconditional obligation to purchase such stock.

Rev. Rul. 69–608

Advice has been requested as to the treatment for Federal income tax purposes of the redemption by a corporation of a retiring shareholder's stock where the remaining shareholder of the corporation has entered into a contract to purchase such stock.

Where the stock of a corporation is held by a small group of people, it is often considered necessary to the continuity of the corporation to have the individuals enter into agreements among themselves to provide for the disposition of the stock of the corporation in the event of the resignation, death, or incapacity of one of them. Such agreements are generally reciprocal among the shareholders and usually provide that on the resignation, death, or incapacity of one of the principal shareholders, the remaining shareholders will purchase his stock. Frequently such agreements are assigned to the corporation by the remaining shareholder and the corporation actually redeems its stock from the retiring shareholder.

Where a corporation redeems stock from a retiring shareholder, the fact that the corporation in purchasing the shares satisfies the continuing shareholder's executory contractual obligation to purchase the redeemed shares does not result in a distribution to the continuing shareholder provided that the continuing shareholder is not subject to an existing primary and unconditional obligation to perform the contract and that the corporation pays no more than fair market value for the stock redeemed.

On the other hand, if the continuing shareholder, at the time of the assignment to the corporation of his contract to purchase the retiring shareholder's stock, is subject to an unconditional obligation to purchase the retiring shareholder's stock, the satisfaction by the corporation of his obligation results in a constructive distribution to him. The constructive distribution is taxable as a distribution under section 301 of the Internal Revenue Code of 1954.

If the continuing shareholder assigns his stock purchase contract to the redeeming corporation prior to the time when he incurs a primary and unconditional obligation to pay for the shares of stock, no distribution to him will result. If, on the other hand, the assignment takes place after the time when the continuing shareholder is so obligated, a distribution to him will result. While a pre-existing obligation to perform in the future is a necessary element in establishing a distribution in this type of case, it is not until the obligor's duty to perform becomes unconditional that it can be said a primary and unconditional obligation arises.

The application of the above principles may be illustrated by the situations described below.

Situation 1

A and *B* are unrelated individuals who own all of the outstanding stock of corporation *X*. *A* and *B* enter into an agreement that provides in the event *B* leaves the employ of *X*, he will sell his *X* stock to *A* at a price fixed by the agreement. The agreement provides that within a specified number of days of *B*'s offer to sell, *A* will purchase at the price fixed by the agreement all of the *X* stock owned by *B*. *B* terminates his employment and tenders the *X* stock to *A*. Instead of purchasing the stock himself in accordance with the terms of the agreement, *A* causes *X* to assume the contract and to redeem its stock held by *B*. In this case, *A* had a primary and unconditional obligation to perform his contract with *B* at the time the contract was assigned to *X*. Therefore, the redemption by *X* of its stock held by *B* will result in a constructive distribution to *A*. See *William J. and Georgia K. Sullivan* v. *United States of America,* 244 F. Supp. 605 (1965), affirmed, 363 F. 2d 724 (1966), certiorari denied, 387 U.S. 905 (1967), rehearing denied, 388 U.S. 924 (1967).

Situation 2

A and *B* are unrelated individuals who own all of the outstanding stock of corporation *X*. An agreement between them provides unconditionally that within ninety days of the death of either *A* or *B*, the survivor will purchase the decedent's stock of *X* from his estate. Following the death of *B*, *A* causes *X* to assume the contract and redeem the stock from *B*'s estate.

The assignment of the contract to *X* followed by the redemption by *X* of the stock owned by *B*'s estate will result in a constructive distribution to *A* because immediately on the death of *B*, *A* had a primary and unconditional obligation to perform the contract.

Situation 3

All of the stock of *X* corporation was owned by a trust that was to terminate in 1968. Individuals *A* and *B* were the beneficiaries of the trust. Since *B* was the trustee of the trust, he had exclusive management authority over *X* through his control of the board of directors. In 1966, *A* paid to *B* the sum of $25x$ dollars and promised to pay an additional $20x$ dollars to *B* in 1969 for *B*'s interest in the corpus and accumulations of the trust plus *B*'s agreement to resign immediately as supervisor of the trust and release his control over the management of the corporation. The actual transfer of the stock held in trust was to take place on termination of the trust in 1968. In 1969, *X* reimbursed *A* for the $25x$ dollars previously paid to *B*, paid $20x$ dollars to *B*, and received the *X* stock held by *B*.

For all practical purposes, *A* became the owner of *B*'s shares in 1966. Although naked legal title to the shares could not be transferred until the trust terminated in 1968, *B* did transfer all of his beneficial and equitable ownership of the *X* stock to *A* in exchange for an immediate payment by *A* of $25x$ dollars and an unconditional promise to pay an additional $20x$ dollars upon termination of the trust. The payment by *X* of $20x$ dollars to *B* and $25x$ dollars to *A* in 1969 constituted a constructive distribution to *A* in the amount of $45x$ dollars. See *Schalk Chemical Company* v. *Commissioner,*

32 T.C. 879 (1959), affirmed 304 F. 2d, 48 (1962).

Situation 4

A and *B* owned all of the outstanding stock of *X* corporation. *A* and *B* entered into a contract under which, if *B* desired to sell his *X* stock, *A* agreed to purchase the stock or to cause such stock to be purchased. If *B* chose to sell his *X* stock to any person other than *A*, he could do so at any time. In accordance with the terms of the contract, *A* caused *X* to redeem all of *B*'s stock in *X*.

At the time of the redemption, *B* was free to sell his stock to *A* or to any other person, and *A* had no unconditional obligation to purchase the stock and no fixed liability to pay for the stock. Accordingly, the redemption by *X* did not result in a constructive distribution to *A*. See *S. K. Ames, Inc.*, v. *Commissioner*, 46 B.T.A. 1020 (1942), acquiescence, C.B. 1942–1, 1.

Situation 5

A and *B* owned all of the outstanding stock of *X* corporation. An agreement between *A* and *B* provided that upon the death of either, *X* will redeem all of the *X* stock owned by the decedent at the time of his death. In the event that *X* does not redeem the shares from the estate, the agreement provided that the surviving shareholder would purchase the unredeemed shares from the decedent's estate. *B* died and, in accordance with the agreement, *X* redeemed all of the shares owned by his estate.

In this case *A* was only secondarily liable under the agreement between *A* and *B*. Since *A* was not primarily obligated to purchase the *X* stock from the estate of *B*, he received no constructive distribution when *X* redeemed the stock.

Situation 6

B owned all of the outstanding stock of *X* corporation. *A* and *B* entered into an agreement under which *A* was to purchase all of the *X* stock from *B*. *A* did not contemplate purchasing the *X* stock in his own name. Therefore, the contract between *A* and *B* specifically provided that it could be assigned by *A* to a corporation and that, if the corporation agreed to be bound by the terms, *A* would be released from the contract.

A organized *Y* corporation and assigned the stock purchase contract to it. *Y* borrowed funds and purchased all of the *X* stock from *B* pursuant to the agreement. Subsequently *Y* was merged into *X* and *X* assumed the liabilities that *Y* incurred in connection with the purchase of the *X* stock and subsequently satisfied these liabilities.

The purchase by *Y* of the stock of *X* did not result in a constructive distribution to *A*. Since *A* did not contemplate purchasing the *X* stock in his own name, he provided in the contract that it could be assigned to a corporation prior to the closing date. *A* chose this latter alternative and assigned the contract to *Y*. *A* was not personally subject to an unconditional obligation to purchase the *X* stock from *B*. See *Arthur J. Kobacker and Sara Jo Kobacker, et al.* v. *Commissioner*, 37 T.C. 882 (1962), acquiescence, C.B. 1964–2, 6. Compare *Ray Edenfield* v. *Commissioner*, 19 T.C. 13 (1952), acquiescence, C.B. 1953–1, 4.

Situation 7

A and *B* owned all of the outstanding stock of *X* corporation. An agreement between the shareholders provided that upon the death of either, the survivor would purchase the decedent's shares from his estate at a price provided in the agreement. Subsequently, the agreement was rescinded and a new agreement entered into which provided that upon the death of either *A* or *B*, *X* would redeem all of the decedent's shares of *X* stock from his estate.

The cancellation of the original contract between the parties in favor of the new contract did not result in a constructive distribution to either *A* or *B*. At the time *X* agreed to purchase the stock pursuant to the terms of the new agreement, neither *A* nor *B* had an unconditional obligation to purchase shares of *X* stock. The subsequent redemption of the stock from the estate of either pursuant to the terms of the new agreement will not constitute a constructive distribution to the surviving shareholder.

Section 303.—Distributions in Redemption of Stock to Pay Death Taxes

26 CFR 1.303–2: Requirements.

Blocks of stock of two corporations held at date of death are considered separate stock for purposes of the percentage requirements of section 303(b)(2) of the Code even though shares of one are converted into shares of the other in a nontaxable exchange before the alternate valuation date.

Rev. Rul. 69–594

Advice has been requested whether the requirements of section 303(b)(2) of the Internal Revenue Code of 1954 are satisfied under the circumstances described below.

As of the date of his death, *A* owned 40 percent of the stock of corporation *X* and 45 percent of the stock of corporation *Y*. The value of this stock was required to be included in determining the gross estate of *A*. As of the date of *A*'s death, the value of his *X* stock was neither more than 35 percent of the value of his gross estate nor more than 50 percent of his taxable estate. Likewise, the value of his *Y* stock did not exceed either of those percentages. However, the sum of the values of the stock of *X* and *Y* did exceed these percentages.

Within one year after the date of death of *A*, *Y* acquired, for a valid business purpose, all the stock of *X* in a transaction that qualified as a reorganization within the meaning of section 368(a)(1)(B) of the Code. The estate of *A* exchanged all its stock of *X* for additional shares of *Y* without recognition of gain or loss under section 354 of the Code. On the alternate valuation date described in section 2032 of the Code, the value of all the stock of *Y* held by the estate of

A exceeded 35 percent of the value of the gross estate of *A*. The estate of *A* elected to value the gross estate as of the alternate date and thereafter all the stock of *Y* was redeemed. The estate of *A* claimed that the benefits of section 303 of the Code were applicable to the distribution in redemption of the *Y* stock.

Section 303(a) of the Code provides that a distribution of property to a shareholder by a corporation in redemption of part or all of its stock which (for Federal estate tax purposes) is included in determining the gross estate of a decedent, to the extent that such distribution does not exceed the sum of certain taxes imposed because of the decedent's death and the amount of funeral and administration expenses allowable as deductions to the estate under section 2053 of the Code, will be treated as a distribution in full payment in exchange for the stock so redeemed.

Section 303(b)(2)(A) of the Code provides that in order to qualify for the treatment described in section 303(a) of the Code, the value (for Federal estate tax purposes) of all of the stock of the corporation that is included in determining the value of the decedent's gross estate must be either more than 35 percent of the value of the gross estate of such decedent, or more than 50 percent of the taxable estate of such decedent. When a decedent's estate includes stock of two or more corporations, section 303(b)(2)(B) of the Code provides that, for purposes of the 35 percent and 50 percent requirements of section 303(b)(2)(A) of the Code, the stock of two or more corporations may be treated as the stock of one corporation provided more than 75 percent in value of the outstanding stock of each corporation is included in determining the value of the gross estate.

In alternate-valuation-date cases, section 1.303–2(b) of the Income Tax Regulations provides that for purposes of section 303(b)(2) of the Code, the value of the gross estate, the taxable estate, and the stock will each be determined on the applicable date prescribed in section 2032 of the Code.

Section 303(c) of the Code provides that if a shareholder owns stock of a corporation (new stock) that was acquired in exchange for stock of a corporation (old stock), that was included in determining a decedent's gross estate, and a distribution of property to such shareholder in redemption of the old stock would have been accorded the benefits of section 303(a) of the Code, then subject to the time limitation of section 303(b)(1) of the Code, such treatment will be available with respect to a distribution in redemption of the new stock. Section 1.303–2(d) of the regulations provides, in part, that if stock includible in determining the value of the decedent's gross estate is exchanged for new stock, the basis of which is determined by reference to the basis of the old stock, the redemption of the new stock will be treated the same under section 303 of the Code as the redemption of the old stock would have been. Stock received by a decedent's estate in connection with a reorganization under section 368 of the Code is to be treated as described above.

In the instant case the *X* stock and the *Y* stock were two separate assets owned by *A* at the time of his death. For the purpose of determining the applicability of section 303(b)(2) of the Code, it is held that those assets remained separate and distinguishable even though the estate elected, under the provisions of section 2032 of the Code, to value the gross estate as of the date one year after the decedent's death. It is immaterial for this purpose that between the date of death and the alternate valuation date the *X* stock had been exchanged for an additional block of *Y* stock in a nontaxable transaction.

Accordingly, for the purpose of section 303(b)(2) of the Code, the estate held two blocks of *Y* stock on the alternate valuation date, one of which merely represented the *X* stock held by *A* on the date of his death. The value of each block of *Y* stock is to be taken into account separately (at the alternate valuation date) in determining whether the percentage requirements of section 303(b)(2) of the Code are satisfied.

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26 CFR 1.303–2: Requirements.
(Also Section 2041; 20.2041–1.)

Shares of stock of a predeceased wife's estate considered owned by a husband's estate for purposes of meeting the percentage requirements of section 303 of the Code where he died before distributions were made to him and before exercising his power of appointment.

Rev. Rul. 69–616

Advice as been requested as to the number of shares that may be redeemed to pay death taxes and funeral and administrative expenses under section 303 of the Internal Revenue Code of 1954 under the circumstances described below.

Individual *A* died and a part of her estate consisted of 36*x* shares of a corporation's common stock. *A*'s will devised to a trust for the benefit of her surviving spouse that exact portion of her estate assets necessary to permit the allowance of the maximum marital deduction on the Federal estate tax return filed for her estate. The executor of *A*'s estate was given the discretionary power to transfer to the trustee cash, or assets in kind at their finally determined value for Federal estate tax purposes. The net income of the trust was to be distributed to individual *B*, the surviving spouse, during his lifetime and he was given a general testamentary power of appointment over the assets held by the marital trust.

The executor entered into an agreement with the Internal Revenue Service in accordance with the procedures set forth in Revenue Procedure 64–19, C.B. 1964–1 (Part 1), 682, relating to the amount of the marital deduction in cases where there is some uncertainty as to the ultimate distribution to be made in payment of a pecuniary be-

quest or transfer in trust where the trustee may satisfy bequests in kind with assets at their value as finally determined for Federal estate tax purposes. The executor also agreed to distribute to *B*, that proportion of the stock of the corporation held by the estate, that was equal to the proportion of *A*'s entire estate distributable to *B*.

B died before he had exercised the power of appointment and before the assets in *A*'s estate had been distributed even though they were available for distribution. If the distribution of the assets in *A*'s estate had been made on the date of *B*'s death, the marital trust would have received 66⅔ percent of the total assets of *A*'s estate available for distribution pursuant to the agreement executed under Revenue Procedure 64–19.

The question presented is how many shares of stock of the corporation may be considered held by *B*'s estate for the purpose of determining whether the stock owned by *B*'s estate meets the percentage requirements for a redemption under section 303 of the Code.

Section 303(a) of the Code provides, in effect, that a distribution of property to a shareholder by a corporation in redemption of stock, the value of which is included in determining the value of the gross estate of a decedent, will be treated as a distribution in full payment in exchange for the stock so redeemed, to the extent that the distribution does not exceed the sum of the estate, inheritance, legacy, and succession taxes (plus interest) and the amount of funeral and administration expenses allowable as deductions for Federal estate tax purposes.

Section 303(b)(2)(A) of the Code provides, in part, that section 303(a) of the Code will apply only if the value of the stock of the redeeming corporation included in determining the value of the decedent's gross estate is either more than 35 percent of the value of the gross estate, or more than 50 percent of the taxable estate.

Section 2041 of the Code states, in part, that the value of the decedent's gross estate includes property over which the decedent had a general power of appointment.

By virtue of the agreement filed under Revenue Procedure 64–19, the executor agreed that the assets to be distributed in satisfaction of the transfer in trust would be selected in such a manner that the cash and other property distributed would have an aggregate fair market value representative of the transferee's proportionate share of the appreciation or depreciation in the value to the date of distribution of all the property then available for distribution in satisfaction of the transfer in trust. Thus, the marital trust set up in *A*'s will would have received 66⅔ percent of each asset available for distribution, including 24*x* shares (36*x* shares x 66⅔ percent) of the corporation's stock.

Since no assets from *A*'s estate had been distributed prior to *B*'s death, he did not own any specific assets of *A*'s estate directly. However, under section 2041 of the Code, the value of the marital trust is includible in *B*'s gross estate for Federal estate tax purposes as property over which he had a general power of appointment, even though the property passed directly to the remaindermen since *B* had not exercised his power of appointment as provided in the trust.

Accordingly, under the facts in this case, the proportionate number of shares of common stock of the corporation that the value of the marital trust bears to the value of *A*'s estate, or 24*x* shares, are includible in determining the value of *B*'s estate. This number of shares may be added to the number of shares of stock of the corporation owned directly by *B*'s estate for purposes of determining whether the stock of the corporation owned by the estate of *B* meets the percentage requirements for a redemption under section 303 of the Code.

Subpart C. Definitions; Constructive Ownership of Stock

Section 316.—Dividend Defined

26 CFR 1.316–2: Sources of distribution in general.

If total distributions for two classes of stock are in excess of earnings and profits, dividends must be regarded as having been distributed to those stockholders having priority under corporate charter before any distributions to stockholders with lesser priority; G.C.M. 21122 superseded.

Rev. Rul. 69–440 [1]

The purpose of this Revenue Ruling is to update and restate under the current statute and regulations the position set forth in G.C.M. 21122, C.B. 1939–1 (Part 1), 187.

The question presented concerns the source of distributions under section 316 of the Internal Revenue Code of 1954 and section 1.316–2 of the Income Tax Regulations when such distributions are made with respect to classes of stock having priority over other classes of stock and the sum of the payments on all classes for the year is in excess of the earnings and profits.

In 1968 a corporation had outstanding common stock, prior preferred cumulative stock entitled under the corporate charter to dividends at the rate of $6 per share before the payment of any dividend on any other class, and cumulative convertible stock entitled to cumulative dividends at the rate of $2 per share. During the year the corporation made distributions on the prior preferred stock in the total amount of $6 per share and on the cumulative convertible stock in the total amount of $2 per share. The total amount distributed in 1968 was 35*x* dollars but the corporation had earnings and profits for the taxable year 1968 of only 24*x* dollars and had no accumulated earnings and profits as of January 1, 1968. The earnings and profits of the corporation were sufficient to cover the

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

dividend requirements on the prior preferred stock, and if applied first to the dividends on that stock, would leave earnings and profits to be applied to the dividends paid on the cumulative convertible stock equal to 12 percent of the amount distributed to holders of such stock. On the other hand, if the earnings and profits were prorated as to all the dividends paid, 68.57 percent of the amount received by the holders of each class of stock would be regarded as a distribution of earnings and profits and the remainder would constitute a distribution of capital. Section 1.316–2 of the regulations provides that if the distributions made during the taxable year exceed the earnings and profits of such year, that proportion of each distribution that the total of the earnings and profits of the year bears to the total distributions made during the year shall be regarded as out of the earnings or profits of that year.

There is nothing in section 316 of the Code which impairs the contractual right of the stockholders. The pertinent portion of that section reads as follows:

"SEC. 316. DIVIDEND DEFINED.

(a) GENERAL RULE.—For purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—(1) * * *, or (2) out of 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."

This provision is substantially the same as section 115(a). In explanation of the last clause, the Senate Committee on Finance in its report on the 1936 revenue bill (Report No. 2156, June 1, 1936, page 18) stated:

"In order to enable corporations without regard to deficits existing at the beginning of the taxable year to obtain the benefit of the dividends paid credit for the purposes of the undistributed profits surtax, section 115(a) changes the definition of a dividend so as to include distributions out of the earnings or profits of the current taxable year. The amendment simplifies the determination by providing that distributions during the year, not exceeding in amount the current earnings, are dividends constituting taxable income to the shareholder and a dividends paid credit to the corporation. As respects such dividends the complicated determination of accumulated earnings or profits is rendered unnecessary."

Thus, it appears that Congress intended that a corporation should compute its net earnings and profits as of the end of the year, and that if dividend distributions had been made in excess of that amount, the amount of each distribution that was paid out of earnings and profits would be determined on the pro rata basis rather than looking to the actual earnings on hand at the time of each distribution. However, it does not follow that where dividends are paid to different classes of stockholders the priorities as between stockholders must be disregarded. If, for example, a corporation earns only an amount sufficient to meet its preferred stock requirements and pays the required dividends on its preferred stock and also makes distributions on its common stock, the preferred stockholders should, nevertheless, report as dividends the entire amount distributed to them even though the corporation also made distributions to its common stockholders which, when added to the preferred stock dividends, were in excess of the corporate earnings and profits for that year. In such a case, if the preferred stockholders are entitled to payment of their dividends before any distribution can be made to common stockholders, it is apparent that the earnings and profits are used first for the preferred stockholders, and if the earnings and profits are thereby exhausted, the payments to the common stockholders merely reduce their equity and constitute in effect a return of capital.

The right of a preferred stockholder to preference out of the earnings of the corporation for each year was recognized in *Barclay et al.* v. *Wabash Ry. Co. et al.*, 30 F. 2d, 260 (1929), wherein the court granted a decree forbidding payment of the dividends on junior stock out of earnings accumulated during the year for which the preferred dividends had not been paid. Thus, the preferred stockholders have an equitable claim on the earnings of the corporation for each year that must be met before any part of those earnings can be paid to other classes of stockholders.

Accordingly, in the present case, the earnings and profits must be regarded as having been first used for the payment of the dividends on the prior preferred stock as required by the charter of the corporation and the contract with the prior preferred stockholders, and only the earnings and profits remaining after such dividend requirements have been met should be regarded as having been paid to the junior stockholders. In other words, the earnings and profits of the corporation for the year 1968 must be regarded as having been distributed in accordance with the provisions of the corporate charter giving the prior preferred stockholders the right to dividends before any earnings and profits can be distributed to the other stockholders.

G.C.M. 21122 is hereby superseded since the position stated therein is restated under current law in this Revenue Ruling.

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26 CFR 1.316–2: Sources of distribution in general.

Appropriate year from which dividends are paid for foreign tax credit purposes. See Rev. Rul. 69–447, page 153.

Section 318.—Constructive Ownership of Stock

26 CFR 1.318–3: Estates, trusts, and options.

An option to purchase its own stock from one of its stockholders

does not make a corporation the owner of the stock, under section 318(a)(4) of the Code, for the purpose of making another stockholder an indirect owner of that stock.

Rev. Rul. 69–562

A corporation had 100x shares of common stock outstanding, all of which were owned by *A*, *B*, and *C*, unrelated individuals. *A* owned 50x shares and *B* and *C* each owned 25x shares of the common stock. The corporation had an option to purchase the 25x shares of its common stock owned by *B*.

Held, since the corporation does not acquire voting or other rights as a shareholder by acquiring its own stock through exercise of the option, it is not considered, under section 318(a)(4) of the Internal Revenue Code of 1954, to be the owner of the stock that it has an option to acquire from *B* for the purpose of making *A* the indirect owner of such stock.

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.

A credit on its books by a succeeding partnership of each shareholder-partner's equity in a liquidated corporation is equivalent to a distribution of the corporation's assets and taxable to the partners under section 331 of the Code; I.T. 1323 and S.R. 1240 superseded.

Rev. Rul. 69–534 [1]

A corporation was liquidated and its business was thereafter conducted as a partnership by the three individuals who had owned all of the stock of the corporation and who acquired the same relative interests in the partnership that they had previously held in the corporation.

The account of each partner was credited on the books of the partnership with his share of the equity of the corporation, but no amount was actually distributed to the individuals.

Held, the credit given to each shareholder on the books of the partnership that succeeded the corporation was equivalent to a distribution of such assets to the partners since upon the dissolution of the corporation each of its three shareholders became entitled to his proportionate share of its entire net assets. Accordingly, gain or loss is recognized to each shareholder measured by the difference between his aliquot portion of the fair market value of the assets of the corporation distributed in liquidation and the cost or other basis of his stock as provided by section 331 of the Internal Revenue Code of 1954.

I.T. 1323, C.B. I–1, 24 (1922), and S.R. 1240, C.B. III–2, 14 (1924), are hereby superseded since the position stated therein is set forth under the current statute and regulations in this Revenue Ruling.

Section 332.—Complete Liquidations of Subsidiaries

26 CFR 1.332–1: Distribution in liquidation of subsidiary corporation; general.

In transactions involving complete liquidation of a subsidiary corporation, the term "property," as used in section 332(a) of the Code, includes money; G.C.M. 19435 superseded.

Rev. Rul. 69–379 [1]

Section 332(a) of the Internal Revenue Code of 1954 provides that, subject to the provisions of section 332(b) of the Code, no gain or loss shall be recognized on the receipt by a corporation of property distributed in complete liquidation of another corporation.

Held, the term "property" as used in section 332(a) of the Code includes money.

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

G.C.M. 19435, C.B. 1938–1, 176, is hereby superseded, since the position stated therein is set forth under the current statute and regulations in this Revenue Ruling.

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26 CFR 1.332–2: Requirements for nonrecognition of gain or loss.

Effect of the reorganization provisions of section 368 of the Code on the transfer of the assets of a partially owned subsidiary to a new wholly owned subsidiary. See Rev. Rul. 69–617, page 57.

Section 334.—Basis of Property Received in Liquidations

26 CFR 1.334–1: Basis of property received in liquidations.

A parent corporation's basis of property received, in satisfaction of indebtedness, from a subsidiary that is undergoing complete liquidation, is the same as the subsidiary's basis.

Rev. Rul. 69–426

Advice has been requested as to the method of determining the basis in the hands of a parent corporation of property received from its subsidiary in satisfaction of the subsidiary's indebtedness owed to the parent in the course of a complete liquidation of the subsidiary under the circumstances described below.

X corporation purchased for cash from an unrelated person all the outstanding stock of *Y* corporation and liquidated *Y* less than two years later. At the time of adoption of the plan of liquidation *Y* was indebted to *X*. The indebtedness was satisfied by the transfer of property (other than money) to *X*. The fair market value of the property exceeded its basis to *Y*. The property was sold by *X* immediately thereafter.

Sections 332(a) and 332(b) of the Internal Revenue Code of 1954 provide for nonrecognition of gain or loss to a parent corporation upon the receipt of property distributed in complete liquidation of its subsidiary.

Section 332(c) of the Code provides a special rule that if the subsidiary is

indebted to the parent on the date of adoption of the plan of liquidation, then no gain or loss will be recognized to the subsidiary upon its transfer of property to the parent in satisfaction of such indebtedness.

Section 334(b)(1) of the Code provides that in a liquidation of a subsidiary to which section 332 (a) or (b) of the Code applies, except as provided in section 334(b)(2) of the Code, the basis to the parent of the property received in liquidation with respect to the stock will be the same as the basis in the hands of the distributing subsidiary. In addition, section 334(b)(1) of the Code provides a similar carryover basis rule for property received in a transfer to which section 332(c) of the Code applies, if section 334(b)(2) of the Code does not apply.

On the distribution of property in complete liquidation of a subsidiary corporation, where the requirements of section 334(b)(2) of the Code are met, the basis of the property received by the parent corporation in the distribution will be the adjusted basis of the subsidiary corporation's stock to the parent with respect to which the distribution was made.

However, where a subsidiary transfers property to its parent in satisfaction of indebtedness owing to its parent, the transfer is not a distribution with respect to stock. Section 1.334–1(c)(1) of the Income Tax Regulations provides, in part, that property received with reference to stock owned by the parent corporation immediately before the liquidation is the only property to which section 334(b)(2) of the Code is applicable. Thus, the basis of the property received in satisfaction of indebtedness is governed by section 334(b)(1) of the Code.

Accordingly, the basis in the hands of *X* of the property received by *X* in satisfaction of the indebtedness owed to *X* by *Y* at the time of liquidation of *Y* is the same as the basis of such property in the hands of *Y*, as provided in section 334(b)(1) of the Code.

Subpart C. Collapsible Corporations; Foreign Personal Holding Companies

Section 341.—Collapsible Corporations

26 CFR 1.341–2: Definitions.
(Also 1.341–4.)

The leasing of land, approving lessee's construction plans, sharing rents, and subordinating title by a corporate lessor is "construction" which is completed the date following actual full physical construction for purposes of section 341 of the Code.

Rev. Rul. 69–378

Advice has been requested whether, under the circumstances described below, a corporation has engaged in "construction" within the meaning of section 341 of the Internal Revenue Code of 1954, and, if so, the date such construction was completed for purposes of section 341(d)(3) of the Code.

Corporation *X* was organized to plan, construct, equip, own, rent, lease and operate shopping centers. *X* owned certain real estate upon which it intended to construct a shopping center but was unable to obtain necessary financing to construct the shopping center.

In March 1966, *X* negotiated a ground lease with *Y* corporation under which *Y* was to construct and operate a shopping center on *X*'s property. The lease provides that *Y* is to pay *X* a fixed annual rental plus a certain percentage of the gross rentals collected by *Y* under subleases of space in the shopping center entered into by *Y* with other parties. The lease also provides that *X* agrees to subject its title to the property to a construction mortgage and join *Y* in executing such mortgage, and that *X* must approve *Y*'s plans for the construction of the shopping center. On June 21, 1966, *X* subjected its title in the property to a construction mortgage, joined *Y* in the execution of such mortgage, and approved *Y*'s plans for the construction of the shopping center. Construction of the shopping center was begun shortly thereafter by *Y*. *X* did not participate in any way in the physical construction that was completed by *Y* on August 16, 1967. At the present time, *X* has not realized a substantial part of the taxable income to be realized from the shopping center property.

Section 341(a) of the Code provides, in part, as follows:

Gain from * * * the sale or exchange of stock of a collapsible corporation * * * to the extent that it would be considered (but for the provisions of this section) as gain from the sale or exchange of a capital asset held for more than 6 months shall, except as otherwise provided in this section, be considered as gain from the sale or exchange of property which is not a capital asset.

The definition of a collapsible corporation contained in section 341(b)(1) of the Code includes the following:

* * * a corporation formed or availed of principally for the * * * construction * * * of property * * * with a view to—

(A) the sale or exchange of stock by its shareholders (whether in liquidation or otherwise), or a distribution to its shareholders, before the realization by the corporation manufacturing, constructing, producing, or purchasing the property of a substantial part of the taxable income to be derived from such property, and

(B) the realization by such shareholders of gain attributable to such property.

Section 341(b)(2) of the Code provides, in part, as follows:

* * * For purposes of paragraph (1), a corporation shall be deemed to have * * * constructed * * * property, if—

(A) it engaged in the * * * construction * * * of * * * property to any extent,

* * * * *

Section 341(d) of the Code provides, in part, as follows:

LIMITATIONS ON APPLICATION OF SECTION.—In the case of gain realized by a shareholder with respect to his

stock in a collapsible corporation, this section shall not apply—

* * * * *

(3) to gain realized after the expiration of 3 years following the completion of such manufacture, construction, production, or purchase.

Thus, to determine the applicability of section 341(a) of the Code to the shareholders, it is essential to ascertain (1) whether the corporation engaged in construction activities within the meaning of section 341 of the Code and (2) whether such construction activities were completed more than three years prior to the time when the shareholders realized gain with respect to their stock.

Generally, whether particular activities are "construction" within the meaning of section 341 of the Code is a factual question dependent on the relevant facts and circumstances.

In the instant case, the leasing by *X* of its property, *X*'s approval of the plans for the construction of the shopping center, the sharing by *X* of the rents collected by *Y* under the subleases, and the subordination of its title to such property in connection with obtaining the construction loan were integral steps in the construction of property (the shopping center) within the meaning of section 341 of the Code. The fact that *X* did not actually engage in the physical construction of the shopping center is not material since section 341(b)(2) of the Code states that a corporation shall be deemed to have constructed property if it engaged in the construction of property "to any extent." See *Ellsworth J. Sterner* v. *Commissioner,* 32 T.C. 1144 (1959), wherein it was held that certain activities of a corporation preliminary to the commencement of physical construction of an apartment building that was subsequently constructed by another corporation were "construction" within the meaning of section 117(m) of the 1939 Code (section 341 of the 1954 Code) since such term was intended to have its broadest scope.

Accordingly, the above described activities of *X* in connection with the physical construction of the shopping center are "construction" within the meaning of section 341 of the Code.

With regard to the question of when construction of the shopping center was completed for purposes of the limitation contained in section 341(d)(3) of the Code, the date that *X* subjected its title to its property to the construction mortgage is not the date on which construction was completed notwithstanding the fact that *X* did not participate after this date in the construction of the shopping center. Completion of construction for purposes of section 341(d)(3) of the Code means actual full completion. See *Edward Weil* v. *Commissioner,* 28 T.C. 809 (1957), affirmed per curiam, 252 F. 2d 805 (1958).

Accordingly, in the instant case the three-year period referred to in section 341(d)(3) of the Code commenced on August 17, 1967, the date following actual full completion of the shopping center. Thus, if there is no further construction activity with relation to *X*'s property, gain realized by the shareholders of *X* on or after August 17, 1970, will not be subject to section 341(a) of the Code by reason of the limitation contained in section 341(d)(3) of the Code.

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26 CFR 1.341–4: Limitations on application of section.

When "completion" of construction occurs with regard to a lessor-corporation where a lessee constructs property on land of the lessor-corporation. See Rev. Rul. 69–378, page 49.

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.

Whether gain is recognized by the transferor where trade accounts and notes payable assumed by a newly-formed corporation exceed the basis of the assets transferred in a transaction otherwise subject to section 351 of the Code. See Rev. Rul. 69–442, page 53.

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

Conditions or circumstances under which an advance ruling will be issued under section 367 of the Code that an agreement which purports to furnish technical "know-how" in exchange for stock is a transfer of property under section 351. See Rev. Proc. 69–19, page 301.

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 share accounts representing a proprietary interest in a mutual association for similar accounts in another mutual association will be pursuant to a reorganization. See Rev. Rul. 69–646, page 54.

Section 355.—Distribution of Stock and Securities of a Controlled Corporation

26 CFR 1.355–1: Distribution of stock and securities of controlled corporation. (Also Section 368; 1.368–2.)

The distribution of stock of a controlled corporation to shareholders of the controlling corporation, following a recapitalization which resulted in 80 percent control, is a nontaxable distribution under section 355 of the Code.

Rev. Rul. 69–407

Advice has been requested whether section 355 of the Internal Revenue Code of 1954 applies to the distribution of stock of a controlled corporation in the circumstances described below.

All of the outstanding stock of corporation *Y* was represented by 1,000 shares of $100 par value common stock. Corporation *X* owned 70 percent of the stock of *Y* and the balance was owned by *A* and *B* who did not own directly or indirectly any stock of *X*. Both corporations had been engaged in the active conduct of their respective businesses for more than five years, and all of the stock of *Y* owned

by *X* had been held by it for more than five years.

Pursuant to a plan of recapitalization, *Y* issued 200 shares of $150 par value Class A voting common stock to *A* and *B* in exchange for the 300 shares of $100 par value common stock held by them. *Y* issued 800 shares of $87.50 par value Class B voting common stock to *X* in exchange for the 700 shares of $100 par value common stock held by it. The value of the stock received was equal to the value of the stock surrendered. The Class A and Class B common stocks had one vote each and were entitled to share in dividends paid by *Y* and in the assets of *Y* in the event of liquidation in proportion to the relative par values of the stocks. Thus the recapitalization did not change the proportionate interests of *A*, *B* and *X* in corporation *Y* but only altered the proportionate voting rights of the parties. After the recapitalization, the Class B stock owned by *X* represented 80 percent of the total combined voting power of all classes of common stock of *Y* entitled to vote. The purpose for the recapitalization of *Y* was to create a class of stock that will be available to key employees of *Y* and to facilitate the transaction described below.

After the recapitalization and for valid business reasons *X* distributed all of the Class B common stock of *Y* owned by it to its shareholders on a pro rata basis. Both *X* and *Y* continued the active conduct of their respective businesses.

Section 355(a) of the Code provides that if, (1) a corporation distributes to its shareholders, with respect to its stock, solely the stock of a corporation that it controlled immediately before the distribution, (2) the transaction is not used principally as a device for the distribution of earnings and profits, and (3) the requirements of section 355(b) of the Code are satisfied, no gain or loss will be recognized to the shareholders.

Section 355(b) of the Code requires that both the distributing corporation and the controlled corporation be engaged immediately after the distribution in the active conduct of a trade or business that has been actively conducted throughout the five-year period ending on the date of distribution and that was not acquired within the five-year period in a transaction in which gain or loss was recognized in whole or in part. The distributing corporation cannot have acquired the stock of the controlled corporation within the five-year period ending on the date of the distribution in a transaction in which gain or loss was recognized.

The term "control" for purposes of section 355 of the Code means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of each class of nonvoting stock of the corporation, as defined in section 368(c) of the Code.

The transaction in which *Y* issued to its shareholders shares of new Class A voting common stock and new Class B voting common stock in exchange for all of its outstanding stock constituted a recapitalization and therefore a reorganization within the meaning of section 368(a)(1)(E) of the Code. No gain or loss was recognized to the shareholders of *Y* as a result of the exchange of their stock for new Class A voting common stock or new Class B voting common stock under the provisions of section 354 of the Code.

Although *X* owned only 70 percent of the outstanding voting stock of *Y* for the greater part of the five-year period prior to the distribution, it acquired sufficient (80 percent) voting stock of *Y* immediately prior to the transaction to give it control of *Y* within the meaning of section 368(c) of the Code. Since the stock was acquired in a transaction in which no gain or loss was recognized by reason of section 354 of the Code, the requirements of section 355(b)(2)(C) of the Code were met and *Y* is treated as engaged in an active trade or business for purposes of section 355 of the Code.

Accordingly, no gain or loss will be recognized to (and no amount will be includible in the income of) the shareholders of *X* on the distribution to them of the stock of *Y* as provided in section 355 of the Code. See Revenue Ruling 56–117, C.B. 1956–1, 180, in which a similar transaction was held to constitute a recapitalization qualifying under section 368(a)(1)(E) of the Code followed by a distribution pursuant to section 355 of the Code.

This case is distinguishable from the situation covered in Revenue Ruling 63–260, C.B. 1963–2, 147, which holds that where *A* owned all of the stock of which *X* owned 70 percent of the stock of *Y* (*A* owned the other 30 percent), a transfer of ten percent of the shares of *Y* stock by *A* to *X* prior to a distribution by *X* of 80 percent of the shares of *Y* stock to *A* does not qualify as a nontaxable distribution under the provisions of section 355 of the Code since *X* did not have "control" of *Y* within the meaning of section 368(c) of the Code immediately before the distribution except in a transitory and illusory sense. Here the recapitalization that preceded the distribution of *Y* stock to the shareholders of *X* resulted in a permanent realignment of voting control.

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26 CFR 1.355–2: Limitations.

Examples illustrate the application of the "business purpose requirement" prescribed by section 1.355–2(c) of the regulations to a distribution of stock of a controlled corporation that otherwise qualifies under section 355 of the Code.

Rev. Rul. 69–460

Advice has been requested regarding the application of the "business purpose requirement" prescribed by section 1.355–2(c) of the Income Tax Regulations to a distribution of stock of a controlled corporation that otherwise qualifies under section 355 of the Internal Revenue Code of 1954.

Section 1.355–2(c) of the regulations states that the distribution by a corporation of stock or securities of a con-

trolled corporation to its shareholders with respect to its own stock or to its security holders in exchange for its own securities will not qualify under section 355 of the Code where carried out for purposes not germane to the business of the corporations. This provision makes it clear that section 355 of the Code applies only to certain specified distributions or exchanges of the stock or securities of controlled corporations incident to the readjustment of corporate structures required by business exigencies and which effect only a readjustment of continuing interests in property under modified corporate forms.

In order that the distribution of stock qualify under section 355 of the Code it is essential that there be a valid business purpose whether the distribution of the stock of the controlled corporation is a distribution of the stock of an existing subsidiary or a distribution pursuant to a reorganization under section 368(a)(1)(D) of the Code. The fact that there is a valid business reason for the creation of a new corporation does not necessarily satisfy the business purpose requirement for the distribution of the stock pursuant to section 355 of the Code. In the case of *Commissioner* v. *Marne S. Wilson,* 353 F. 2d 184 (1965), reversing 42 T.C. (1964), the court stated that even if there is no tax avoidance motive, a distribution of stock of a controlled corporation, such distribution having no business purpose, does not result in the tax advantages which section 355 of the Code confers upon those who satisfy the legal requirements for its benefits.

The application of the business purpose requirement is illustrated in the situations described below.

Situation 1.

X corporation has been engaged in business as a liquor wholesaler for the last five years. The stock of *X* is owned equally by *A* (president) and *B* (general manager), who are unrelated to each other.

Serious disputes between *A* and *B* as to expansion, marketing channels, and discount policy have created a situation where the parties are so antagonistic that the normal operations of the business are seriously affected. It is therefore proposed that 50 percent of the operating assets and liabilities relating thereto be transferred to *Y* corporation in exchange for all the stock of *Y*, followed by the distribution of the *Y* stock to *B*, solely in exchange for the surrender by *B* of all of his *X* stock.

The non pro rata distribution was undertaken for reasons germane to corporate business problems and was necessary for the future conduct of the business. Therefore, the business purpose requirement as set forth in section 1.355–2(c) of the regulations is satisfied.

Situation 2.

X corporation, the stock of which is closely held by one family, is engaged in the manufacture of precision scientific equipment. *X* owns all the stock of *Y* corporation which is in the tool and die business.

Due to competition, *X* has had difficulty in retaining key managerial personnel. Certain top management employees of *X* have indicated that they would consider remaining with the company if they could be given a proprietary interest in *X* through the opportunity to purchase a stock interest. At the present time any significant stock interest in *X* would be expensive due primarily to the inclusion of the *Y* stock in the assets of *X*. Moreover, *X* is not desirous of giving its employees any interest in the *Y* business.

X, therefore, proposes to distribute all of *Y*'s stock pro rata to its shareholders. *X* will then sell stock to three key employees in an amount that will give each of them a five percent interest in *X*. The distribution will be undertaken for reasons germane to the business of the corporation. Therefore, the business purpose requirement as set forth in section 1.355–2(c) of the regulations is satisfied.

Situation 3.

A owns all of the stock of *X* corporation which is engaged in the shoe business. *X* owns 85 percent of the stock of *Y* corporation which is engaged in the manufacturing and sale of skiing equipment. The skiing equipment business has prospered in the past few years and *B*, the operating manager of *Y*, is desirous of sharing in the future profits of *Y* by the purchase of a nominal stock interest in *Y*. It is immaterial to *B* whether the majority shareholder of *Y* is *X* or *A*. In order to sell *B* a five percent stock interest in *Y*, *X* will distribute all the stock in *Y* to *A*.

B could have purchased his five percent stock interest of *Y* from *X* or directly from *Y* without the necessity of having *X* distribute the *Y* stock to *A* and having *A* make the sale. The sale of stock to a key employee is a valid business and corporate purpose. However, the stock distribution was not necessary to carry out such a purpose. Therefore, the transaction will result in a distribution taxable to *A* as provided by section 301 of the Code.

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26 CFR 1.355–4: Active conduct of a trade or business.

The "active conduct of a trade or business" requirement under section 355(b)(2)(D)(ii) of the Code is satisfied where the stock in a controlled corporation, acquired by a wholly-owned subsidiary in 1963 and transferred to its parent in 1966, was distributed by the parent to its shareholders in 1969.

Rev. Rul. 69–461

Advice has been requested whether the transaction described below satisfies the active trade or business requirements of section 355(b)(2)(D) of the Internal Revenue Code of 1954.

X corporation has operated a business since 1960 and has owned all the stock of *Y* corporation which has conducted an active trade or business since its incorporation in 1961. In 1963 *Y* purchased for cash 100 percent of the

outstanding stock of *Z* corporation, which conducts an active trade or business. In 1966 *Y* distributed all of the stock of *Z* to its shareholder, *X*. In 1969 *X* distributed the *Z* stock to its shareholders in a distribution that was intended to qualify under section 355 of the Code.

Section 355 of the Code provides rules for the distribution, without recognition of gain or loss to the shareholders, of stock of a corporation controlled by the distributing corporation. For such treatment section 355(b) of the Code requires that both the distributing corporation and the controlled corporation must be engaged in the active conduct of a trade or business.

Section 355(b)(2)(D) of the Code provides that a corporation will be treated as engaged in the active conduct of a trade or business if and only if control of the corporation which (at the time of acquisition of control) was conducting such trade or business, was not acquired directly by another corporation within the five-year period described in subparagraph (B), or was so acquired by another corporation within such period, but such control was so acquired only by reason of transactions in which gain or loss was not recognized in whole or in part, or only by reason of such transactions combined with acquisitions before the beginning of such period.

In order to prevent a distributing corporation from accumulating excess funds to purchase the stock of an active business and immediately distributing the stock of such corporation to its shareholders, section 355(b)(2)(D)(ii) of the Code provides that the distributing corporation cannot have acquired the stock of the controlled corporation during the five-year period. However, where control was acquired by the distributing corporation in a transaction in which gain or loss was not recognized, the distributing corporation is permitted to include in its holding period the time that the controlled corporation was held by another party. Conversely, where control is acquired in a transaction in which gain or loss is recognized, the distributing corporation cannot distribute to its shareholders the stock of the controlled corporation within the five-year period and qualify the transaction under section 355 of the Code.

Distributions of stock from one corporation to another corporation, where the distributee is in control of the distributor is not the type of transaction to which section 355(b)(2)(D) of the Code was intended to apply. Section 355(b)(2)(D) of the Code was intended to prevent the acquisition of stock of a corporation conducting an active trade or business in a taxable transaction from a party not within the direct or indirect control of the distributing corporation.

Where the distributing corporation acquires the stock of the controlled corporation as the result of a distribution from a subsidiary that merely has the effect of converting indirect control into direct control, the abuse that section 355(b)(2)(D) of the Code was designed to prevent is not present. This section of the Code applies to a transaction in which stock is acquired from a corporation *outside* a direct chain of ownership.

Under the views expressed above, the distribution of *Z* stock by *Y* to *X* is a transaction that should be disregarded for purposes of determining whether *X* acquired the stock of *Z* within the five-year period in a taxable transaction.

Accordingly, since the *Z* stock was acquired by *Y* at least five years prior to the time that *X* distributed such stock to its shareholders the requirement of section 355(b)(2)(D) of the Code is satisfied and provided all the other requirements of section 355 of the Code are met, the distribution by *X* in 1969 qualifies as a distribution under section 355(a)(1) of the Code.

Section 357.—Assumption of Liability

26 CFR 1.357–2: Liabilities in excess of basis.
(Also Section 351; 1.351–1.)

For purposes of recognition of gain under section 357(c) of the Code, trade accounts receivable transferred in a section 351 transaction by a cash method taxpayer are given a zero basis.

Rev. Rul. 69–442

In the case of *Peter and Wanda J. Raich* v. *Commissioner,* 46 T.C. 604 (1966), the petitioner conducted a sheetrock and drywall contracting business under the name of Pete Raich Sheetrock Taping Service. The business was conducted as a sole proprietorship, the income of which was reported on the cash receipts and disbursements method of accounting. The taxpayer transferred to a newly organized corporation all of the assets of the sole proprietorship in exchange for all of the stock of the corporation plus the assumption by the corporation of all of the liabilities of the sole proprietorship in a transaction that met the requirements of section 351 of the Internal Revenue Code of 1954. The liabilities assumed by the corporation consisted of trade accounts payable and notes payable. The assets transferred consisted substantially of trade accounts receivable that had not been taken into income under the taxpayer's method of accounting.

The Tax Court of the United States held that the trade accounts receivable had a zero basis in the hands of the taxapayer who reported his income on the cash receipts and disbursements method of accounting. The liabilities assumed by the corporation were in excess of the adjusted basis of all of the assets transferred. The Tax Court applied section 357(c) of the Code to the excess of the liabilities assumed over the adjusted basis of the assets transferred and held that the taxpayer realized a gain on the transfer to the extent of such excess.

The Internal Revenue Service will apply section 357(c) of the Code to other situations involving similar facts inasmuch as such section literally applies and the legislative history clearly supports the application of that section under such circumstances. However, the Service wishes to point out that the trade accounts receivable would not have had a zero basis if the taxpayer had been on the accrual method of accounting prior to the transfer of the business under section 351 of the Code.

Subpart D. Special Rule; Definitions

Section 367.—Foreign Corporations

26 CFR 1.367–1: Foreign corporations.

Conditions or circumstances under which an advance ruling will be issued under section 367 of the Code that an agreement which purports to furnish technical "know-how" in exchange for stock is a transfer of property under section 351. See Rev. Proc. 69–19, page 301.

Section 368.—Definitions Relating to Corporate Reorganizations

26 CFR 1.368–1: Purpose and scope of exception of reorganization exchanges.

The payment by an acquired corporation to its shareholders, subsequent to a corporate reorganization, of a regular year-end dividend declared prior to the exchange of stock will not adversely affect the "solely for voting stock" requirement of section 368(a)(1)(B) of the Code.

Rev. Rul. 69–443

On November 1 Corporation *Y* declared its regular annual year-end dividend payable on January 31 to shareholders of record on November 1. On January 1 Corporation *X* acquired all of the outstanding stock of *Y* solely in exchange for voting stock of *X*. On January 31 *Y* paid the dividend to its shareholders of record on November 1 of the prior year out of its own funds.

Held, the cash received by the former shareholders of *Y* is a distribution to which section 301 of the Internal Revenue Code of 1954 applies and is not part of the consideration given by *X* in connection with the exchange of stock and thus it does not adversely affect the "solely for voting stock" requirement of section 368(a)(1)(B) of the Code.

26 CFR 1.368–1: Purpose and scope of exception of reorganization exchanges. (Also Section 354; 1.354–1.)

A merger of two building and loan associations, whereby the acquired association's shareholders exchanged their passbook accounts and equity interests for equal passbook accounts and guaranty shares of the acquiring association, is a reorganization under section 368(a)(1)(A) of the Code.

Rev. Rul. 69–646

Advice has been requested whether, under the circumstances described below, the acquisition of all the assets and liabilities of a savings and loan association by another savings and loan association is a reorganization under section 368(a)(1)(A) of the Internal Revenue Code of 1954.

X corporation and *Y* corporation are both incorporated in the same state and both are domestic building and loan associations within the meaning of section 7701(a)(19) of the Code. Each has the power to issue an unlimited number of free (savings) shares.

All of the equity of *X* is evidenced by free (savings) shares. Each *X* shareholder is entitled to cast one vote for each of his paid up free (savings) shares. In the event of liquidation the *X* shareholders are entitled to a pro rata distribution of all the remaining assets of *X* including the undivided profits and reserves. Under local law the holder of free (savings) shares in a building and loan association has the same rights as a shareholder in any other type of corporation, but he does not receive stock represented by certificates. Instead, the passbook that he receives represents simultaneous evidence of the ownership of paid-up free (savings) shares, amounts paid toward the purchase of additional free (savings) shares, dividends received, and the right to the remaining assets including the undivided profits and reserves.

Y is a stock corporation with an authorized capital consisting of free (savings) shares and guaranty shares. Each fully paid free (savings) share is entitled to one vote and the holders of the guaranty shares are entitled to one vote for each guaranty share.

A holder of free (savings) shares of *Y* may withdraw all or any part of his free (savings) shares account at any time. In any liquidation, dissolution, or winding up of *Y* no assets will be distributed to the holders of guaranty shares until all claims against *Y* have been fully satisfied and all free (savings) share accounts have been paid their full withdrawal value (the amount deposited with the association as shown by the passbook account, plus accumulated interest). The holders of the free (savings) shares are entitled to only the withdrawal value of such shares. The holders of the guaranty shares are entitled to all of the undivided profits and reserves of *Y* that remain after the claims of creditors and the holders of free (savings) shares have been satisfied.

X proposes to merge with and into *Y* under the applicable laws of the state of incorporation. Pursuant to the plan, all the assets of *X* will vest in, and all the liabilities of *X* will be assumed by, *Y* on the effective date of the merger. Each *X* shareholder who consents to the merger will exchange his *X* passbook for a free (savings) share passbook of *Y* that reflects the same dollar amount as reflected in his *X* passbook on the date of the exchange. Each *X* shareholder will also receive a stock certificate for that number of *Y* guaranty shares equal to the fair market value of his equity interest in *X* divided by the fair market value of the *Y* guaranty shares. Fractional interests in *Y* guaranty shares will be paid to the *X* shareholders in cash.

Section 368(a)(1)(A) of the Code provides that the term "reorganization" includes a statutory merger or consoli-

dation. Section 1.368–1(b) of the Income Tax Regulations provides that an otherwise qualified transaction does not constitute a reorganization within the meaning of the Code unless the continuity of interest requirement is satisfied.

In the instant case the entire equity interest in *X*, including the right to vote on matters affecting the association, the right to share in current earnings, and the right to share in the assets of *X* on liquidation, is vested in the *X* shareholders, who as members of *X* own passbooks evidencing their interests.

The passbooks to be issued by *Y* to the shareholders of *X* will reflect the same dollar amount as reflected in the *X* passbooks on the date of the exchange. The fair market value of the guaranty shares of *Y*, plus any cash paid in lieu of fractional shares, will be equal to the *X* shareholder's pro rata interest in the undivided profits and reserves of *X* on the date of the exchange. In no instance will an *X* shareholder receive a *Y* passbook reflecting an account balance greater or less than that appearing in his *X* passbook on the date of the exchange, nor will the fair market value of the guaranty shares and any cash in lieu of fractional shares received by an *X* shareholder be greater or less than his pro rata interest in the undivided profits and reserves of *X* on the date of the exchange.

Revenue Ruling 69–3, C.B. 1969–1, 103, holds that the substitution of cash deposits in one mutual savings and loan association for identical cash deposits in another was not significant. In that case the passbooks of both associations involved in the reorganization represented both the equity of the shareholders and the amount of their savings accounts. It was held that the substance of the exchange of passbooks in one association for passbooks of the other was an equity-for-equity exchange that satisfied the continuity of interest requirement.

In the case under consideration, the passbooks of the *X* shareholders represent both their savings account balances and their equity interest in the corporation. The receipt of the passbooks of *Y* is a substitution of one cash deposit for another. The guaranty shares of *Y* are received in exchange for the equity interests in *X* and the substance of the transaction is solely an equity-for-equity exchange that satisfies the continuity of interest requirements.

Accordingly, under these facts, the transaction is a reorganization within the meaning of section 368(a)(1)(A) of the Code. No gain or loss will be recognized to the *X* shareholders on the exchange of their equity interest in *X* as represented by their passbooks for the guaranty shares of *Y* (including any fractional share interests to which they may be entitled) or on the exchange of their passbook accounts for passbook accounts of the same amount in *Y* as provided in section 354 of the Code. Cash paid in lieu of fractional share interests in the guaranty shares of *Y* will be treated as a redemption of such fractional shares in accordance with Revenue Ruling 66–365, C.B. 1966–2, 116.

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26 CFR 1.368–1: Purpose and scope of exception of reorganization exchanges.

Whether the election of a small business corporation is terminated if it is the surviving corporation in a statutory merger with another corporation. See Rev. Rul. 69–566, page 165.

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26 CFR 1.368–2: Definition of terms. (Also Section 381; 1.381(a)–1.)

A newly created subsidiary acquiring the assets of a partially owned subsidiary of a common parent under a section 368(a)(1)(C) reorganization may not carry back subsequent operating losses to prior years of the transferor subsidiary.

Rev. Rul. 69–413

Advice has been requested whether, under the circumstances described below, a transaction qualifying as a reorganization within the meaning of section 368(a)(1)(C) of the Internal Revenue Code of 1954 also qualifies as a reorganization defined in section 368(a)(1)(F) of the Code with the result that net operating losses incurred by a newly created acquiring corporation in the period following the reorganization may be carried back to a prior taxable year of the acquired corporation, pursuant to the provisions of section 381(b) of the Code and section 1.381(b)–1(a)(2) of the Income Tax Regulations.

Corporation *P* owned ninety-nine percent of the outstanding stock of corporation *S*, an operating subsidiary. For good business reasons, *P* created a new subsidiary corporation *N* which acquired substantially all of the assets of *S* in exchange solely for shares of the voting stock of *P* and the assumption by *N* of the liabilities of *S*. *S* distributed the stock of *P* to its shareholders in exchange for all of its outstanding stock and dissolved. The transaction qualified as a reorganization defined in section 368(a)(1)(C) of the Code since substantially all of the assets of *S* were acquired by *N* in exchange solely for part of the voting stock of *P* which was in control of both *S* and *N*, and all of the *P* stock received was exchange for all of the stock of *S* pursuant to section 354(a)(1) of the Code.

Subsequent to the reorganization, *N* incurred operating losses. The specific question presented is whether *N* may carry back such losses to a taxable year of *S* ended before the date of the reorganization.

Section 381(a)(2) of the Code provides, as the general rule concerning the application of the provisions of section 381 to corporate reorganizations involving transfers of property, that, the provisions of section 381 of the Code will apply provided (1) that section 361 of the Code is applicable to the transfer of property and (2) that the reorganization qualifies under section 368(a)(1)(A), (C), (D) or (F) of the Code. Section 381(b) of the Code provides that except in the case of a reorganization qualifying under section 368(a)(1)(F) of the Code, the corporation acquiring property in the transfer or distribution is not entitled to carry back a net

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operating loss for a taxable year ending after the date of transfer to a taxable year of the distributor or transferor corporation. Section 1.381(b)–1(a)(2) of the regulations provides that in a reorganization qualifying under section 368(a)(1)(F) of the Code, whether or not such reorganization also qualifies under any other provision of section 368(a)(1) of the Code, the acquiring corporation is to be treated for purposes of section 381 of the Code just as the transferor corporation would have been treated had there been no reorganization.

A reorganization as defined in section 368(a)(1)(F) of the Code is "a mere change in identity, form, or place of organization, however effected."

Section 361 of the Code provides that no gain or loss will be recognized on the transfer of property where the transferor corporation and the corporation whose stock is exchanged for the property are each "a party to a reorganization" as that term is defined in section 368(b) of the Code.

Section 368(b) of the Code provides, in part, that the term "a party to a reorganization" includes a corporation resulting from a reorganization and both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

Section 368(b) of the Code further provides, in part, that where a transaction qualifies as a reorganization within the definition of section 368(a)(1)(A) of the Code by (virtue of section 368(a)(2)(D)), section 368(a)(1)(B), or 368(a)(1)(C) of the Code and the stock exchanged for the stock or properties is stock of a corporation that is in control of the corporation, the corporation so controlling the acquiring corporation is "a party to a reorganization." However, section 368(b) of the Code does not include as "a party to a reorganization" the corporation controlling the acquiring corporation in a reorganization qualifying under section 368(a)(1)(F) of the Code.

Under the facts described above, section 361 of the Code is not applicable to the transfer of the property of *S* to *N* in exchange for voting stock of *P* since *P* does not qualify as "a party to the reorganization" within the definition of section 368(b) of the Code applicable to reorganizations described in section 368(a)(1)(F) of the Code. Since section 361 of the Code is not applicable to the transfer of the property of *S* to *N* for purposes of section 368(a)(1)(F) of the Code, the transaction is not a reorganization under section 368(a)(1)(F) of the Code and, therefore, section 1.381(b)–1(a)(2) of the regulations has no application to the transaction.

Accordingly, since the transaction is not a reorganization under section 368(a)(1)(F) of the Code, the taxable year of *S* ends under section 381(b) of the Code on the date of the transfer of assets to *N* and *N* is not permitted to carry back its net operating loss to a taxable year of *S* ended before the date of the transfer of assets.

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26 CFR 1.368–2: Definition of terms.

The merger of a corporation with one created in another state is a section 368(a)(1)(F) reorganization even though it is a part of an overall plan for a third corporation to acquire the assets of the new corporation within the meaning of section 368(a)(1)(C) of the Code.

Rev. Rul. 69–516

Advice has been requested whether, under the circumstances described below, a change of place of incorporation of a corporation may be a "reorganization" within the meaning of section 368(a)(1)(F) of the Internal Revenue Code of 1954.

Corporation *X* desired to acquire substantially all of the assets of corporation *Y* in a transaction within the meaning of section 368(a)(1)(C) of the Code. For valid business purposes and as part of an overall plan, *Y* organized *Z* in another state and merged into *Z* in accordance with the applicable state laws. Immediately thereafter, substantially all of the *Z* assets were acquired by *X* solely in exchange for *X* voting stock. The *X* voting stock was distributed to the *Z* shareholders and *Z* was then dissolved.

In order for a transaction to qualify under section 368(a)(1) of the Code, there must be a continuation of interest on the part of the persons who were the owners of the enterprise prior to the reorganization. See section 1.368–1(b) of the Income Tax Regulations. In the instant case *Y* merely changed its place of incorporation. The *Y* shareholders had the same interests in *Z* after the exchange as they had in *Y* before the exchange.

Accordingly, the change of state of incorporation qualified as a reorganization under section 368(a)(1)(F) of the Code even though it was a step in the transaction in which *X* acquired substantially all of the assets of *Z* in a transaction within the meaning of section 368(a)(1)(C) of the Code.

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26 CFR 1.368–2: Definition of terms.

The "control" requirements of section 368(a)(1)(B) of the Code are satisfied where 75 percent of a corporation's stock is acquired in exchange solely for voting stock and 25 percent of the stock is received as a dividend by the acquiring corporation from its subsidiary.

Rev. Rul. 69–585

Advice has been requested whether, under the circumstances described below, an acquisition of all of the stock of a corporation is a "reorganization" within the meaning of section 368(a)(1)(B) of the Internal Revenue Code of 1954.

Corporation *X* for valid business reasons desired to acquire control of corporation *Z*. For many years 25 percent of the stock of *Z* has been owned by corporation *Y*, a wholly owned subsidiary of *X*, and the remaining 75 per-

cent has been owned by the general public.

X entered into an agreement with all the shareholders of *Z* (except *Y*) to acquire all of their stock of *Z* in exchange solely for voting stock of *X*. At the same time, as part of the plan, the remaining 25 percent of the stock of *Z* was distributed by *Y* as a dividend to *X*.

Section 368(a)(1)(B) of the Code provides that the term "reorganization" means the acquisition by one corporation in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), 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 368(c) of the Code states that for purposes of section 368(a)(1)(B) of the Code, "control" means the ownership of stock possessing at least eighty percent of the total combined voting power of all classes of stock entitled to vote and at least eighty percent of the total number of shares of all other classes of stock of the corporation.

Immediately after the transaction by which *X* acquired a portion of the *Z* stock in exchange for *X* voting stock and the balance of the *Z* stock as a dividend distribution from *Y*, *X* owned 100 percent of the outstanding stock of *Z*. Thus, since *X* owned more than 80 percent of the stock of *Z*, the control requirements of section 368(c) of the Code have been satisfied.

Under the facts of the case, 75 percent of the stock of *Z* was acquired in exchange solely for voting stock of *X*. Although the balance of the 25 percent of the stock of *Z* that *X* received as a dividend from *Y* was a distribution (rather than an exchange) with respect to the stock of *Y* owned by *X*, *X* did not surrender any property or any of its stock to *Y* in this acquisition. *X* thus exchanged solely its voting stock in the transaction.

Accordingly, since *X* transferred solely its voting stock in the exchange and immediately after the transaction was in control of *Z* as provided in section 368(c) of the Code, the acquisition of the stock of *Z* is a reorganization as defined in section 368(a)(1)(B) of the Code.

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26 CFR 1.368–2: Definition of terms. (Also Section 332; 1.332–2.)

The merger of one corporation into another owning more than eighty percent of its stock and immediate transfer of the acquired corporation's assets and liabilities to a new wholly owned subsidiary is a reorganization under sections 368 (a)(1)(A) and 368 (a)(2)(C) of the Code.

Rev. Rul. 69–617

Advice has been requested whether the transaction described below qualifies as a reorganization within the meaning of sections 368(a)(1)(A) and 368(a)(2)(C) of the Internal Revenue Code of 1954.

Corporation *P* owned more than eighty percent of the outstanding stock of corporation *S*. The balance of the outstanding stock of *S* was publicly held. For valid business reasons, *P* wanted to have the business of *S* conducted by a wholly owned subsidiary. In order to accomplish this result, *S* was merged into *P* pursuant to the laws of the states in which they were incorporated. The stock of *S* owned by *P* was cancelled and the minority shareholders of *S* received shares of common stock of *P* in exchange for their *S* stock. *P* then transferred all of the assets received from *S*, subject to all the liabilities of *S*, to its new subsidiary, corporation *X*.

Section 368(a)(1)(A) of the Code provides that the term "reorganization" includes a statutory merger or consolidation. Section 368(a)(2)(C) of the Code provides, in part, that a transaction otherwise qualifying under paragraph (1)(A) of section 368(a) of the Code will not be disqualified by reason of the fact that part or all of the assets that were acquired in the transaction are transferred to a corporation controlled by the corporation acquiring such assets. Section 1.368–2(b) of the Income Tax Regulations provides that the words "statutory merger or consolidation" refer to a merger or consolidation effected pursuant to the corporation laws of the United States or a State or Territory or the District of Columbia.

Section 332 of the Code provides that no gain or loss will be recognized on the receipt by a corporation of property distributed in complete liquidation of a subsidiary corporation under certain prescribed statutory provisions.

The specific question presented is whether the transfer of the assets of *S* to *P* may qualify as a reorganization inasmuch as the transfer is literally within the language of section 332 of the Code.

The purpose of the transaction in this case, was to have the business operated by *S*, a partially owned subsidiary, transferred to a wholly owned subsidiary. Since the assets of *S* were immediately transferred by *P* to *X*, there was no complete liquidation of *S* within the meaning of section 332 of the Code. However, the fact that *P* owned more than eighty percent of the stock of *S* does not prevent the transfer of the assets of *S* to *P* from qualifying as a statutory merger, where such assets are transferred to another subsidiary.

Accordingly, in the instant case, the merger of *S* into *P* followed by the transfer to *X* of all of the assets of *S*, subject to its liabilities, is a statutory merger within the meaning of sections 368(a)(1)(A) and 368(a)(2)(C) of the Code.

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26 CFR 1.368–2: Definition of terms.

Recapitalization of a corporation prior to a distribution under section 355 of the Internal Revenue Code of 1954. See Rev. Rul. 69–407, page 50.

Part V. Carryovers

Section 381.—Carryovers in Certain Corporate Acquisitions

26 CFR 1.381(a)–1: General rule relating to carryovers in certain corporate acquisitions.

Application of carryback provisions to certain reorganizations under section 368 of the Internal Revenue Code of 1954. See Rev. Rul. 69–413, page 55.

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26 CFR 1.381(c)(4)–1: Method of accounting.

Carryover of reserve for bad debts by a building and loan association. See Rev. Rul. 69–374, page 139.

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.

The coverage classification in a profit sharing plan does not meet the requirements of section 401 (a)(3)(B) of the Code where five of the six participants receive substantially more compensation than the excluded employees.

Rev. Rul. 69–398

Advice has been requested whether, under the circumstances described below, the coverage classification in a profit-sharing plan meets the requirements of section 401(a)(3)(B) of the Internal Revenue Code of 1954.

An employer established a profit-sharing plan for the benefit of its full-time salaried employees. The plan provided that all full-time salaried employees with three years of service were eligible to participate in the plan. The employer had fourteen full-time employees each of whom had completed three full years of service. However, only six of these employees were participants in the plan; the other eight employees were ineligible to participate because they were paid on an hourly basis.

The six participating employees included the president and sole stockholder, the vice president and supervisor of sales personnel, a foreman, two salesmen, and a bookkeeper. The compensation of each of the full-time employees is set out below:

Salaried (participants)	*Hourly-paid (excluded)*
$30,000	$7,000
12,000	7,000
10,000	6,000
9,000	6,000
8,500	5,500
6,500	5,500
	5,500
	4,500

A plan intended to qualify under section 401(a) of the Code must cover either (1) a number of employees that is at least equal to that determined under the percentage provisions of section 401(a)(3)(A) of the Code, or (2) such employees who qualify under a nondiscriminatory classification within the purview of section 401(a)(3)(B). The latter section provides that a plan intended to qualify must benefit a classification of employees that is found not to discriminate in favor of employees who are officers, shareholders, supervisors, or highly compensated. Thus, a plan that does not meet the percentage tests may still meet the coverage requirements if the classification of employees actually covered does not result in the prohibited discrimination. The classification must be nondiscriminatory both on its face and in actual operation. See section 1.401–1(b)(3) of the Income Tax Regulations.

Section 401(a)(5) of the Code specifies certain classifications, such as salaried or clerical, which of themselves are not discriminatory. Thus, a classification is not considered discriminatory solely because it is limited to salaried or clerical employees. See Rev. Rul. 66–12, C.B. 1966–1, 72. Conversely, such a classification is not automatically nondiscriminatory. See Rev. Rul. 66–13, C.B. 1966–1, 73. All of the surrounding circumstances and attendant facts must be taken into account in determining whether the coverage classification is nondiscriminatory within the meaning of section 401(a)(3)(B) of the Code. See section 1.401–1(b)(3) of the regulations.

Revenue Ruling 56–497, C.B. 1956–2, 284, indicates that with regard to qualified plans the terms "highly compensated" and "lower compensated" are relative and the distinction between them must be based upon the facts and circumstances in each case. Thus, in a particular case, the compensation of all employees, those excluded from the plan as well as those included, is taken into account in determining what is meant by "highly compensated" under section 401(a)(3)(B) of the Code. See *Commissioner* v. *Pepsi-Cola Niagara Bottling Corporation,* 399 F. 2d 390 (1968).

The plan in the instant case does not meet the minimum percentage requirement of section 401(a)(3)(A) of the Code. Therefore, if the coverage requirements are to be met, the classification of participants must not discriminate in favor of employees enumerated in section 401(a)(3)(B).

Of the six participants in the plan under consideration, the highest paid five received substantially more compensation than the excluded employees, with the fifth highest paid covered employee receiving $1,500 more than the highest paid excluded employee. Thus, all participants except the one who is the lowest paid are highly compensated in this particular company and therefore members of the group in whose favor discrimination is prohibited.

It is held that the coverage classification in this profit-sharing plan does not meet the requirements of section 401(a)(3)(B) of the Code since it results in discrimination in favor of employees who are officers, shareholders, supervisors, or highly compensated.

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26 CFR 1.401–1: Qualified pension, profit-sharing, and stock bonus plans.

An employees' plan providing pre-retirement death benefits in the form of incidental life insurance purchased with employer contributions does not fail to qualify merely

because it permits the purchase of additional life insurance with voluntary employee contributions.

Rev. Rul. 69–408

An employer established an employees' retirement plan intended to qualify under section 401(a) of the Internal Revenue Code of 1954. The plan provided for preretirement death benefits in the form of life insurance purchased with employer contributions as well as the normal retirement benefits. The life insurance so provided was incidental to the primary purpose of the plan since it did not exceed the limits discussed in Revenue Ruling 60–83, C.B. 1960–1, 157. The plan also permitted voluntary employee contributions of up to ten percent of compensation. A contributing employee could direct that any or all of his voluntary contribution, but not the earnings thereon, be used to purchase additional life insurance annually through a supplemental agreement with the company that provided the other insurance under the plan.

Section 1.401–1(b)(1)(i) of the Income Tax Regulations states that a qualified pension plan may provide for the payment of incidental death benefits through insurance or otherwise. Section 1.401–1(b)(1)(ii) of the regulations states that a qualified profit-sharing plan may provide that amounts allocated to the account of a participant may be used to provide incidental life insurance for him.

Held, the plan in this case does not fail to qualify merely because additional life insurance is purchased with voluntary employee contributions. The requirement of section 1.401–(b)(1)(i) and (ii) of the regulations that death benefits or life insurance be incidental to the primary purpose of the plan does not apply to insurance protection purchased with voluntary employee contributions.

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26 CFR 1.401–1: Qualified pension, profit-sharing, and stock bonus plans.

A provision in a profit-sharing plan providing for distribution of benefits to an employee upon attainment of a stated age regardless of whether he actually retires at that age does not adversely affect the qualification of the plan; PS No. 44 superseded.

Rev. Rul. 69–414 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in PS No. 44, dated December 11, 1944. This ruling relates to the effect on the qualification of a profit-sharing plan under section 401(a) of the Internal Revenue Code of 1954 of various provisions applying in case of continuance in employment after a stated age.

A profit-sharing plan provides that amounts credited to an employee's account shall be distributed to the employee in the year in which he attains age 65 regardless of whether the employee actually retires at that age. An employee who continues in the employment of the employer after age 65 will continue to share in contributions to the plan in the same manner as before age 65. His interest in those contributions made after he attains age 65 shall be distributed to him at the time he actually retires.

Each employee's annual compensation is determined in accordance with a contract entered into with the employer before the beginning of the year.

Under section 1.401–1(b)(1)(ii) of the Income Tax Regulations a profit-sharing plan that qualifies under section 401(a) of the Code must provide for distributing the funds accumulated under the plan after a fixed number of years, the attainment of a stated age, or upon the prior occurrence of some event, such as layoff, illness, disability, retirement, death, or severance of employment.

Since a profit-sharing plan may provide for the distribution of benefits upon the attainment of a stated age, a plan with such a provision may meet the requirements of section 401(a) of the Code regardless of whether the employee actually retires at the stated age. Furthermore, a provision for continued participation under a profit-sharing or stock bonus plan, and for contributions to provide additional benefits for employees who remain in employment beyond the stated age, does not adversely affect the qualification of the plan, if the provision is uniformly applied to all employees under similar circumstances and does not result in prohibited discrimination. Finally, arrangements made between an employer and an employee regarding the compensation to be paid for services rendered have no bearing on the qualification of a profit-sharing plan under section 401(a) of the Code unless, of course, the total deferred and nondeferred compensation is unreasonable. For a discussion of this exception see Revenue Ruling 67–341, C.B. 1967–2, 156.

Based on the foregoing, it is held that the above-described provisions, applying in case of continuance in employment after the stated age, do not adversely affect the qualification of the plan under section 401(a) of the Code.

PS No. 44 is hereby superseded since the position stated therein is restated in this Revenue Ruling.

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

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26 CFR 1.401–1: Qualified pension, profit-sharing, and stock bonus plans.

Updated guides relative to the qualification of employees' pension, annuity, profit-sharing and stock bonus plans under section 401 of the Code.

Rev. Rul. 69–421

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Revenue Rulings and Revenue Procedures cited in this compendium.

PART I.—INTRODUCTION

(a) PURPOSE.—It is the purpose of this Revenue Ruling to provide updated guides by correlating those rulings that have been published relative to the qualification of plans and trusts (except those that include self-employed individuals) with the applicable provisions of the Internal Revenue Code of 1954 and the corresponding Income Tax Regulations. The issues presented are not all-inclusive but have been found to be present in many plans. It is contemplated that as new issues of general import arise additional rulings will be published. Guides that are applicable only to plans that include self-employed individuals are not treated separately in this compendium, but references to provisions of the Code and regulations pertaining to such plans are made as appropriate. Neither are guides included herein with respect to pension or annuity plans that also provide medical benefits for retired employees.

(b) GUIDES PREVIOUSLY PUBLISHED.—There are listed below the compendium-type Revenue Rulings that have been published previously for the purpose of setting forth guides in effect at the time of publication with respect to the qualification of plans.

Revenue Ruling 33, C.B. 1953–1, 267, published on March 16, 1953;

Revenue Ruling 57–163, C.B. 1957–1, 128, published on April 22, 1957;

Revenue Ruling 61–157, C.B. 1961–2, 67, published on August 28, 1961; and

Revenue Ruling 65–178, C.B. 1965–2, 94, published on July 12, 1965.

(c) REFERENCES.—Wherever appropriate throughout this guide, references are made to Revenue Rulings that discuss specific issues more extensively. Reference is made only to those rulings that are within the context of the particular guides presented. The appendix sets forth a tabulation of the rulings referred to, with a reference to the part of this Revenue Ruling in which each is cited. Such a reference in no way affects the conclusion of the Revenue Ruling to which the reference is made.

(d) STATUTORY BACKGROUND.—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 constitutes a qualified trust under section 401(a) of the Code, if it meets the further requirements set forth in that section as to source of contributions, nondiversion, coverage, nondiscrimination in contributions or benefits, nonforfeitable rights on termination, application of forfeitures, and, in the case of a plan covering self-employed individuals, the additional requirements applicable to such plans. A qualified trust is exempt from tax under section 501(a) unless exemption is denied under section 502 because it is operated as a feeder organization, or under section 503 because it has engaged in a prohibited transaction. An exempt trust, however, is subject to tax under section 511 on its unrelated business taxable income. Various tax benefits to employers, employees, and their beneficiaries stem from an exempt trust. A trust, however, is not the only vehicle through which such benefits may be provided. For example, tax deferment and the long-term capital gain treatment are also provided for employees and their beneficiaries under section 403(a) of the Code, and deductions for employer contributions are allowable under section 404(a)(2), in the case of nontrusteed annuity plans that meet the requirements of those sections.

PART 2.—QUALIFIED PENSION, ANNUITY, PROFIT-SHARING, AND STOCK BONUS PLANS

Section 401(a) of the Internal Revenue Code of 1954—Regulations Section 1.401–1

(a) APPLICABLE PLANS.—The provisions of section 401(a) of the Code are applicable only to qualified trusteed pension, profit-sharing, and stock

bonus plans. A custodial account, as defined in section 401(f) of the Code is treated as a qualified trust and is subject to the same requirements that apply to a trust. Nontrusteed annuity plans under which tax deferment and capital gains are provided for in section 403(a) of the Code and deductions for employer contributions are allowable under section 404(a)(2), and qualified bond purchase plans as defined in section 405(a), are subject to some of the requirements of section 401(a) and section 401(d). Paragraphs (3) through (8) of section 401(a) are applicable to all such annuity and bond purchase plans. In addition, if such annuity and bond purchase plans cover self-employed individuals as defined in section 401(c)(1) of the Code, they must also meet the requirements of section 401(a)(9). Furthermore, if any of the self-employed individuals are owner-employees as defined in section 401(c)(3) of the Code, the plans must also satisfy the requirements of sections 401(a)(10) and 401(d), except section 401(d)(1) (bank trustee), but, in the case of bond purchase plans, sections 401(d)(5)(B) (limited contributions) and 401(d)(8) (excess contributions), are not applicable. See section 405(a)(1) of the Code. For definitions of the applicable plans, see the Income Tax Regulations: Section 1.401–1(b)(1)(i) for pension plans, section 1.401–1(b)(1)(ii) for profit-sharing plans, section 1.401–1(b)(1)(iii) for stock bonus plans, section 1.404(a)–3(a) for annuity plans, section 1.401–9 for face-amount certificates treated as annuity contracts, and section 1.405–1(b) for bond purchase plans. Section 1.401–8 describes custodial accounts.

(b) FUNDED PLANS.—A qualified plan must be a funded plan. Contributions may be made to a trust or under a custodial account, or may be used to pay premiums on insurance contracts, or to purchase face-amount certificates or used to buy retirement bonds. A qualified plan does not provide for direct payments by an employer to his employees, as in the case of a pay-as-you-go pension plan. However, employer contributions to or under a recognized funding medium may, under appropriate circumstances, be delayed pursuant to an established funding method. Thus, a qualified pension plan may provide that current contributions be made by employees only, but that the employer is obligated to pay the full amount of the stipulated benefits to each retired employee-participant after the funds in the trust forming a part of such plan have been fully exhausted. See Rev. Rul. 54–152, C.B. 1954–1, 149. The employer may also make contributions in any year to substitute for the otherwise required employee contributions. Rev. Rul. 68–25, C.B. 1968–1, 151. It should be observed, however, that minimum funding requirements must be maintained even if contributions are made by employees only. See part 6(d) hereof.

(c) PLAN OF DEFERRED COMPENSATION.—A qualified plan is a plan of deferred compensation. A pension plan provides systematically for the payment of definitely determinable benefits to employees over a period of years, usually for life, after retirement. See section 1.401–1(b)(1)(i) of the regulations. A plan does not qualify as a pension plan under section 401(a) of the Code where all compensation is deferred and paid after retirement in the form of benefits under the plan. See Rev. Rul. 69–230, C.B. 1969–1, 116. A profit-sharing plan must provide a definite predetermined formula for allocating contributions among participants and for distributing the accumulated funds after a fixed number of years, the attainment of a stated age, or upon the prior occurrence of some event such as layoff, illness, disability, retirement, death, or severance of employment. See section 1.401–1(b)(1)(ii) of the regulations. The term "fixed number of years" is considered to mean at least two years. See Rev. Rul. 54–231, C.B. 1954–1, 150. A specified period, such as the completion of 60 months of participation under the plan is an event on the occurrence of which distibutions may be made. See Rev. Rul. 68–24, C.B. 1968–1, 150. A stock bonus plan is similar to a profit-sharing plan except that the contributions by the employer are not necessarily dependent upon profits and the benefits are distributable in stock of the employer company. See section 1.401–1(b)(1)(iii) of the regulations. A qualified bond purchase plan is established and maintained solely to purchase for and distribute to employees or their beneficiaries U.S. retirement plan bonds. See section 1.405–1(b) of the regulations.

(d) DOMESTIC TRUST.—A qualified employees' trust must be organized or created in the United States and maintained at all times as a domestic trust. See section 1.401–1(a)(3)(i) of the regulations. If, however, a foreign situs trust meets the requirements of section 401(a) of the Code in all other respects, employers making contributions thereunder are allowed deductions within the applicable limits, as provided in section 404(a)(4). Beneficiaries are granted the same tax treatment, in accordance with section 402(c), as is applicable to beneficiaries of a domestic trust. It should be noted, however, that unless a nonresident alien beneficiary is engaged in a trade or business in the United States, or provision is otherwise made by treaty, the long-term capital gain treatment does not apply to distributions to such beneficiary and withholding of tax applies to the distributions, regardless of whether the trust is foreign or domestic. See sections 871 and 1441 of the Code and corresponding regulations.

(e) PLAN AND TRUST OF MULTIPLE EMPLOYERS.—A single plan and trust may be maintained by two or more employers, regardless of their affiliation, but each must meet all applicable requirements. See section 1.401–1(d) of the regulations and Rev. Rul. 69–250, C.B. 1969–1, 116.

(1) *Pooled Funds.*—Where, under specified conditions, separate qualified and exempt trusts pool their funds in a group trust created to provide diversification of investments, the

group trust may also be exempt and the status for exemption of the separate trusts will not be adversely affected. See Rev. Rul. 56–267, C.B. 1956–1, 206, and Rev. Rul. 66–297, C.B. 1966–2, 234.

(2) *Corporate Participation in Joint Ventures.*—Once an employer-employee relationship is established between a partnership or joint venture and the individuals rendering services to the partnership or joint venture, the relationship is also established between those individuals and each partner or joint venturer for purposes of section 401(a) of the Code. Accordingly, a corporation that participates in a joint venture is required to take the employees of the joint venture into account in determining whether its employees' plan meets the requirements of section 401(a) of the Code. See Rev. Rul. 68–370, C.B. 1968–2, 174.

(f) WRITTEN PROGRAM.—A qualified plan must be a definite written program setting forth all provisions essential for qualification. See section 1.401–1(a)(2) of the regulations. In the case of a trusteed plan, there must be a valid existing trust, complete in all respects and recognized as such under the applicable local law, pursuant to a plan in effect. However, in establishing a trust under a plan of an employer on the accrual basis, if only the trust corpus is lacking at the close of the first taxable year, the trust is deemed to be in effect for such taxable year if the corpus is furnished no later than the due date of the employer's return, plus extensions of time in which to file. See Rev. Rul. 57–419, C.B. 1957–2, 264. The trust must be evidenced by an executed written document setting forth the terms thereof. See Rev. Rul. 56–673, C.B. 1956–2, 281, and Rev. Rul. 69–231, C.B. 1969–1, 118. In the case of a nontrusteed annuity plan evidenced only by contracts with an insurance company, the plan is not in effect until such contracts are executed and issued. Where, however, the plan is separate and apart from a group annuity contract, or annuity contracts, the plan may be in effect before the close of the first taxable year if (1) appropriate steps are taken to establish the plan in such year by applying for the insurance contracts pursuant to authorization by the employer's board of directors or acknowledgment in the case of an unincorporated employer, setting forth a definite plan for the purchase of retirement annuities under annuity contracts, under which liability is created to provide the intended benefits, (2) the application has been accepted by the insurance company, the contracts or abstracts have been prepared in sufficient detail setting forth all terms, and at least a part payment of the premiums due has been irrevocably made, and (3) the plan has been communicated to the employees. See Rev. Rul. 59–402, C.B. 1959–2, 122.

(g) SOURCE OF CONTRIBUTIONS.—Contributions to a qualified trust are made by the employer, or employees, or both, or, in the case of a profit-sharing plan or stock bonus plan in which contributions are determined with reference to profits of a group of affiliated corporations, contributions on behalf of employees of a loss member may be made up by the profit-making corporations. See sections 401(a) and 404(a)(3)(B) of the Code. Also, as provided in section 406 of the Code, a domestic corporation may include in its qualified plan, and make contributions on behalf of, employees of a foreign subsidiary who are citizens of the United States and covered for social security benefits in this country, and, in accordance with section 407, a domestic parent corporation may similarly include in its qualified plan, and make contributions on behalf of, employees of a domestic subsidiary who are citizens of the United States engaged in foreign service. Although a qualified plan must provide for contributions by one or more of the parties mentioned above, contributions by others are not precluded. See Rev. Rul. 69–35, C.B. 1969–1, 117. Thus, for example, the past service liability under a pension plan may be funded in whole or in part by a transfer to the pension trust of a portion of the corpus of a fund created by a former director of the employer-bank to provide welfare benefits for employees of the bank, and the current service cost may be funded by the earnings of the balance of the fund, supplemented by contributions from the employer, when necessary, provided that such funding is done on a uniform basis on behalf of all participants. See Rev. Rul. 63–46, C.B. 1963–1, 85. Also, funds may be transferred from a non-exempt welfare fund to an exempt pension trust. See Rev. Rul. 68–223, C.B. 1968–1, 154. Since a profit-sharing plan must provide for participation in the employer's profits, the qualification of such a plan will be adversely affected by an amendment to permit employees to make voluntary contributions prior to the time they become eligible to share in the employer's profits. See Rev. Rul. 68–651, C.B. 1968–2, 167. However, a plan will not fail to qualify as a profit-sharing plan 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. See Rev. Rul. 66–174, C.B. 1966–1, 81.

(h) PERMANENCY.—A qualified plan is a permanent and continuing program. A plan that is abandoned without a valid business reason within a few years after it is set up does not satisfy this requirement. Also, if the plan is discontinued before ample provision is made for comparable benefits for employees other than those in whose favor discrimination is prohibited, it will be deemed not to have been a bona fide program for the exclusive benefit of employees in general from its inception. This is especially true in the case of a pension plan under which benefits are funded at a higher rate for employees in whose favor discrimination is prohibited than for other employees. In the case of a profit-

sharing plan, merely making a single or occasional contribution out of profits for employees does not satisfy the requirement for permanency. There must be recurring and substantial contributions. See section 1.401–1 (b) (2) of the regulations. For a more detailed discussion of the applicable principles and illustrative cases, see Rev. Rul. 55–60, C.B. 1955–1, 37, Rev. Rul. 69–24, C.B. 1969–1, 110, and Rev. Rul. 69–25, C.B. 1969–1, 113. See also section 4.04 of Rev. Proc. 69–4, C.B. 1969–1, 391, at 392, for information to be filed for a determination as to the effect of a curtailment or termination on the prior qualification of a plan; Rev. Rul. 69–252, C.B. 1969–1, 128, as to notice by the trustee on termination of a plan; Rev. Rul. 56–596, C.B. 1956–2, 288, as to the effect of a suspension of contributions; Rev. Rul. 69–157, C.B. 1969–1, 115, as to continued qualification of the plan and exemption of the trust where contributions are discontinued for a valid business reason but the trust is retained to make distributions in accordance with the original terms of the plan; and Rev. Rul. 55–681, C.B. 1955–2, 585, and Rev. Rul. 69–159, C.B. 1969–1, 133, as to union negotiated plans. A qualified profit-sharing plan may, under appropriate circumstances, provide that an employee may elect each year to participate in the trust forming a part of such plan or to accept his share in cash. See, however, parts 4(d) and 5(a) as to meeting the requirements for coverage and nondiscrimination in contributions or benefits. A profit-sharing plan that does not contain a definite contribution formula may qualify if all other applicable requirements are met. See section 1.401–1(b) (1) (ii) of the regulations and Rev. Proc. 56–22, C.B. 1956–2, 1380.

(i) COMMUNICATIONS TO EMPLOYEES.—The employees are to be apprised of the establishment of a qualified plan and the salient provisions thereof. The most effective way of doing so is to furnish each employee with a copy of the plan. Where this is not feasible, however, various substitutes may be used. It will be sufficient that a booklet summarizing the plan in all its essential features be furnished the employees, or that a notice be posted on the company's bulletin board, which must be in conspicuous view, stating that a plan has been established, setting forth the type thereof, specifying the eligibility requirements, containing a synopsis of all benefits provided thereunder, indicating whether employees are to contribute and, if so, the amount or rate of contributions, defining the provisions for vesting, and, in the case of a profit-sharing or stock bonus plan, setting forth the employer contribution formula, if any. In all cases where substitutes are used for furnishing employees with copies of the plan, the medium used must clearly state that a copy of the complete plan may be inspected at a designated place on the company's premises during reasonable times which must be stated.

(j) EMPLOYEE PARTICIPANTS.—A qualified plan must benefit employees or their beneficiaries exclusively. See section 1.401–1(a) (3) (ii) of the regulations. However, a plan is for the exclusive benefit of the employees or their beneficiaries even though it may cover former employees or employees who are temporarily on leave. See section 1.401–1(b) (4) of the regulations. See also, Revenue Ruling 66–175, C.B. 1966–1, 82, which holds that a union-negotiated industry wide pension plan will not fail to qualify merely because it permits certain former employees of participating employers to make voluntary contributions to the trust fund. A self-employed individual who derives earned income from self-employment after December 31, 1962, is considered an employee and may participate in a qualified plan to a limited extent. See section 401(c) (1) of the Code. The term "employee" does not include a self-employed individual when the term "common-law" employee is used or when the context otherwise requires that the term "employee" does not include a self-employed individual. See section 1.401–10(b) (3) of the regulations. A qualified plan cannot be maintained where there are no employees, active or retired, who are covered thereunder. See Rev. Rul. 55–629, C.B. 1955–2, 588. An arrangement does not qualify as a plan under section 401(a) of the Code if the benefits that it provides are not payable to an employee but only to his beneficiary upon his death. See Rev. Rul. 56–656, C.B. 1956–2, 280.

(1) *Partners and Sole Proprietors.*—Except to the limited extent applicable to the participation of self-employed individuals after December 31, 1962, partners and sole proprietors are not employees and therefore are not eligible to participate in a qualified plan. Neither are they to be credited for services as partners or sole proprietors prior to becoming employees in a successor corporation, either for prior service benefits or for meeting eligibility requirements. See Rev. Rul. 69–144, C.B. 1969–1, 115.

(2) *Associates.*—Where an organization is classified as an association taxable as a corporation, and an employer-employee relationship exists between the association and the persons who are associates therein, such associates, if otherwise eligible, may be included in a plan that is intended to qualify under section 401(a) of the Code. The fact that an organization establishes a plan under section 401(a) of the Code is not determinative of whether such organization will be classified as a partnership or as an association taxable as a corporation. See Rev. Rul 57–546, C.B. 1957–2, 886, modifying Rev. Rul. 56–23, C.B. 1956–1, 598. Guides for determining whether an organization is a trust, a partnership, or an association taxable as a corporation are set forth in the Regulations on Procedure and Administration pertaining to section 7701 of the Code, Revenue Procedure 65–27, C.B. 1965–2, 1017, and Revenue Ruling 66–92, C.B. 1966–1, 77, contain the procedures and guides for resolving issues connected with the tax classification of professional service organizations and deferred compen-

sation plans established by such organizations.

(3) *Stockholder Participants.*—Stockholders who are bona fide employees of a corporation may participate in the corporation's plan to the same extent as other employees. See section 1.401–1(b)(3) of the regulations. This is true even though the corporation is an electing small business corporation as defined in section 1371 of the Code. See Rev. Rul. 66–218, C.B. 1966–2, 120. If, however, the plan is designed as a subterfuge for the distribution of profits to stockholders, it will not qualify as a plan for the exclusive benefit of employees. The plan must not be weighted in favor of stockholder-employees with respect to meeting the eligibility requirements or the requirements as to nondiscrimination in contributions or benefits. See section 1.401–1(b)(3) of the regulations. For example, where the coverage requirements of a plan are limited so as to preclude employees other than the company's sole stockholder from participating, the plan does not qualify. See Rev. Rul. 63–108, C.B. 1963–1, 87. For the rules regarding professional service corporations see section 301.7701–2 of the Regulations on Procedure and Administration.

(4) *Attorneys and Other Practitioners.*—An attorney or other professional person may be a bona fide employee and, as such, eligible to participate in a qualified plan. The mere fact that a professional person has an independent income from the practice of his profession will not necessarily preclude him from participating in such a plan. He must, however, be an employee for all purposes, including coverage for social security or a similar public program, if applicable to other employees, and for income tax withholding purposes. If his actual employment for such purposes commences as of a certain date, he is not to be credited for services prior thereto, such as, for example, meeting the years-of-service requirements to be eligible to participate in the plan or to obtain benefits based on past services. An individual, however, may be treated as a self-employed person with respect to one activity and yet be a common-law employee regarding another. For example, an attorney may be a common-law employee of a corporation and maintain an office for his independent practice of law in the evenings.

(5) *Insurance Agents.*—Section 7701(a)(20) of the Code provides that for the purpose of contributions to, and distributions from, a pension, profit-sharing, or stock bonus trust, or under an annuity plan, the term "employee" shall include a full-time life insurance salesman who is considered an employee for the purpose of the Federal Insurance Contribution Act or, in the case of services performed before January 1, 1951, would be considered an employee if his services were performed during 1951. Thus, the same rules apply in determining the eligibilty for inclusion of full-time life insurance salesmen in a qualified plan as are applicable in determining their tax status for old age and survivors disability insurance purposes. Also, such full-time salesmen are treated as "common-law" employees for participation in a plan which includes self-employed individuals. Insurance brokers and others who are not full-time life insurance salesmen within the purview of section 3121(d)(3)(B) of the Code, however, may not be included in a qualified plan except as self-employed individuals.

(k) INVESTMENT OF TRUST FUNDS.—Investments of an exempt employees' trust are subject to the following provisions and requirements: (1) as a function of a trust which under section 401(a) of the Code is part of a plan of an employer for the exclusive benefit of his employees or their beneficiaries, the investments must be consistent with such purpose; (2) the investments must not constitute prohibited transactions, as defined in section 503(c), or section 503(j) if owner-employees are included in the plan; (3) investments that result in unrelated business taxable income subject the trust to tax under section 511 on such income; and (4) the investments must not be used to operate a feeder organization.

(1) *Exclusive Benefit Requirement.*—The primary purpose of benefiting employees or their beneficiaries must be maintained with respect to investments of the trust funds as well as with respect to other activities of the trust. This requirement, however, does not prevent others from also deriving some benefit from a transaction with the trust. For example, a sale of securities at a profit benefits the seller, but if the purchase price is not in excess of the fair market value of the securities at the time of sale and the applicable investment requisites set forth below have been met, the investment is consistent with the exclusive-benefit-of-employees requirement. The requisites are: (1) The cost must not exceed fair market value at time of purchase; (2) a fair return commensurate with the prevailing rate must be provided; (3) sufficient liquidity must be maintained to permit distributions in accordance with the terms of the plan; and (4) the safeguards and diversity that a prudent investor would adhere to must be present. However, the requirement set forth in item (2) with respect to a fair return is not applicable to obligatory investments in employer securities in the case of a stock bonus plan. See Rev. Rul. 69–65, C.B. 1969–1, 114. Upon compliance with these requisites, if the trust instrument and local law permit investments in the stock or securities of the employer, such investments are not deemed to be inconsistent with the purposes of section 401(a) of the Code. The District Director of Internal Revenue, however is to be notified if trust funds are invested in stock or securities of, or loaned to, the employer or related or controlled interests so that a determination may be made whether the trust serves any purpose other than constituting part of a plan for the exclusive benefit of employees. See section 1.401–1(b)(5)(ii) of the regulations. Such notification is to be made as part of the annual information return, Form 990–P, unless an advance determination letter is re-

quested and, if so, at the time of making a request to the appropriate District Director for such letter. The notification is to include the information called for in section 4.05 of Revenue Procedure 69–4, C.B. 1969–1, 391, and be certified by the accounting or other responsible officer.

(2) *Prohibited Transactions.*—Exemption will be denied to an employees' trust that engages in a prohibited transaction within the purview of section 503(c) of the Code, or section 503(j) if owner-employees are included in the plan. Special rules, however, apply to the requirement for adequate security in the case of obligations acquired by the trust under the conditions of section 503(h) of the Code and, pursuant to section 503(i), in the case of loans to unincorporated employers engaged in the stock brokerage business.

(3) *Unrelated Business Taxable Income.*—An exempt employees' trust is taxable under section 511 of the Code on its unrelated business taxable income, as defined in section 512, which is derived from any unrelated trade or business, as defined in section 513. Special rules are set forth in section 514 of the Code with respect to business leases. If business lease indebtedness is incurred, rental income is includible in gross income in the ratio that the business lease indebtedness, at the close of the taxable year, bears to the adjusted basis of the property at such time.

(4) *Feeder Organizations.*—An employees' trust that is operated for the primary purpose of carrying on a trade or business for profit is denied exemption under section 502 of the Code, even though all of its profits are payable to one or more exempt organizations.

(5) *Common Trust Funds.*—The exempt status of an employees' trust will not be adversely affected merely because the trustee, a bank, invests the funds of the trust in a common trust fund maintained by the bank and exempt under section 584 of the Code. See Rev. Rul. 67–301, C.B. 1967–2, 146.

(l) DESIGNATION OF BENEFICIARIES.—Beneficiaries of employees under a qualified plan may be designated by the respective participants without restriction, or they may be restricted under the plan to specified persons or to a group of persons, who are the natural objects of the employee's bounty, his estate, or his dependents. See Rev. Rul. 54–398, C.B. 1954–2, 239.

(m) DEFINITELY DETERMINABLE BENEFITS.—Benefits under a qualified pension plan must be definitely determinable. Benefits are not definitely determinable if funds arising from forfeitures on termination of service, or other reason, may be used to provide increased benefits for the remaining participants instead of being used as soon as possible to reduce the amount of contributions by the employer. See section 1.401–1(b)(1)(i) of the regulations. However, a qualified pension plan may anticipate the effect of forfeitures in determining the costs under the plan. A determination of the amount of forfeitures under such a plan must be made at least once during each taxable year of the employer. See section 1.401–7 of the regulations and part 7(a) hereof. The requirement regarding the application of forfeitures is equally applicable to pension plans of the money-purchase type. See Rev. Rul. 109, C.B. 1953–1, 288, and Rev. Rul. 60–73, C.B. 1960–1, 155. Benefits that vary with the increase or decrease in the market value of the assets from which such benefits are payable or that vary with the fluctuation of a specified and generally recognized cost-of-living index, are consistent with a plan providing for definitely determinable benefits. See Rev. Rul. 185, C.B. 1953–2, 202, and Rev. Rul. 68–116, C.B. 1968–1, 177. In a stock bonus or profit-sharing plan provision may also be made that forfeitures be used to reduce the employer contributions that otherwise would be required under the contribution formula, but such application of forfeitures is not mandatory in plans of these types. See part 7(b) hereof. It should be observed, however, that whatever provision is made for absorbing forfeitures, discrimination in favor of employees who are officers, shareholders, supervisors, or highly compensated must not result.

(n) INCIDENTAL BENEFITS.—Primarily, qualified plans provide the benefits that pertain to the respective types. Thus, a qualified pension plan does not provide for the payment of benefits not customarily included in that type of plan, such as layoff benefits or benefits for sickness, accident, hospitalization, or medical expenses, except hospitalization and medical expenses for retired employees as provided for in section 401(h) of the Code. See sections 1.401–1(b)(1)(i) and 1.401–14 of the regulations. Neither may such a plan provide only such benefits as are furnished through the purchase of ordinary life insurance contracts that may be converted to life annuities at the normal retirement date. See Rev. Rul. 54–67, C.B. 1954–1, 149, and Rev. Rul. 65–25, C.B. 1965–1, 173. However, a provision in a pension plan permitting a retired employee to authorize the trustee to deduct and pay union dues from his monthly pension benefit will not cause the plan to fail to qualify. See Rev. Rul. 68–159, C.B. 1968–1, 153. Furthermore, the annuity portion of an insurance contract by means of which an employees' nontrusteed annuity plan is funded may, if otherwise satisfactory, qualify even though the contract also provides separate term life insurance and accident and health insurance. See Rev. Rul. 56–633, C.B. 1956–2, 279. If life insurance benefits are applied to reduce employer contributions under a pension plan, amounts contributed by the employer for such insurance constitute advance funding and are not currently deductible. See Rev. Rul. 55–748, C.B. 1955–2, 234. Where the life or accident and health insurance features are incidental to the primary benefit of a qualified plan, they may be included in such plan to a limited extent. See section 1.401–1

(b)(1)(i) and section 1.401–14 of the regulations.

(1) *Life Insurance Under Pension and Annuity Plans.*—In a pension or annuity plan funded with insurance contracts, the life insurance benefit is deemed to be incidental where it provides a pre-retirement death benefit no greater than 100 times the monthly annuity, that is, $1,000 of life insurance for each $10 of monthly annuity. See Rev. Rul. 60–83, C.B. 1960–1, 157. This is true even though the pension plan involved is of the money purchase type. However, a money purchase plan may, in the alternative, incorporate the limitation applicable to the incidental use of trust funds to purchase ordinary life insurance contracts under a qualified profit-sharing plan. See Rev. Rul. 66–143, C.B. 1966–1, 79, as clarified by Rev. Rul. 68–31, C.B. 1968–1, 151. The death benefit is similarly incidental in a plan providing a post retirement death benefit equal to 50 percent of base salary in effect in the year preceding retirement, requiring less than 10 percent of the cost of the plan exclusive of the death benefit. See Rev. Rul. 60–59, C.B. 1960–1, 154. Also, the death benefit payable under a qualified pension plan to the widow of an employee who died prior to attaining normal retirement age may be regarded as incidental where the value of such benefit does not exceed the death benefit that would have been payable had the benefit been funded under a typical retirement income contract. See Rev. Rul. 61–121, C.B. 1961–2, 65. Where the plan is funded by ordinary life insurance contracts plus an auxiliary fund, it may permit a pre-retirement death benefit equal to the greater of (a) the proceeds of the ordinary life insurance contracts, or (b) the sum of (i) the reserve under the life insurance contracts and (ii) the employees account in the auxiliary fund. On the other hand, a death benefit equal to the sum of the proceeds of the ordinary life insurance contracts and the amount of the employee's account in the auxiliary fund would exceed the death benefit under a typical level premium retirement income contract with a face amount of 100 times the anticipated monthly retirement benefit, and would preclude the plan from qualifying. See Rev. Rul. 68–453, C.B. 1968–2, 163.

(2) *Life Insurance Under Profit-Sharing Plans.*—In the case of a profit-sharing plan that provides for the use of trust funds that have not been accumulated for at least two years, to purchase and pay premiums on ordinary life insurance contracts, the insurance feature is deemed to be incidental if: (1) The aggregate 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, or 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, C.B. 1954–1, 147, as amplified by Rev. Rul. 57–213, C.B. 1957–1, 157, and Rev. Rul. 60–84, C.B. 1960–1, 159.

(3) *Accident and Health Insurance Under Profit-Sharing Plans.*—Where profit-sharing funds have not been accumulated for at least two years, distributions therefrom to pay premiums for accident and health insurance are treated as incidental if the aggregate of such distributions does not exceed 25 percent of the funds allocated to the account of the participant for whom the insurance is acquired. If such funds are used to purchase both ordinary life and accident and health insurance, the amount expended for accident and health insurance, plus one-half of the premiums paid for ordinary life insurance, may not in the aggregate exceed 25 percent of the funds allocated to an employee's account. See Rev. Rul. 61–164, C.B. 1961–2, 99.

(o) EMPLOYEE WITHDRAWALS UNDER A PENSION PLAN.—A qualified pension plan may provide for the payment, prior to normal retirement, of a pension due to disability and for incidental death benefits through insurance or from the accumulated funds. It may also provide hospitalization and medical benefits for retired employees in accordance with section 401(h) of the Code. Withdrawals of funds by employees for other purposes, however, whether in times of financial need or otherwise, are subject to restrictions.

(1) *Funds Consisting of Employer Contributions or Increments.*—A pension plan must not permit participants, prior to any severance of employment or the termination of the plan, to withdraw all or a part of the funds accumulated on their behalf which consist of employer contributions or fund increments. See Rev. Rul. 69–277, C.B. 1969–1, 116. However, a profit-sharing plan may permit such withdrawals under appropriate circumstances. See Rev. Rul. 60–323, C.B. 1960–2, 148, modifying Rev. Rul. 56–693, C.B. 1956–2, 282.

(2) *Discontinuance of Participation.*—Upon discontinuance of participation in a pension plan, an employee may be permitted to withdraw his own contributions together with an amount that represents the increments actually earned thereon, but not in excess of such increments. See Rev. Rul. 60–281, C.B. 1960–2, 146.

(3) *Employee Voluntary Contributions.*—A pension plan may provide for withdrawals by participants of their voluntary contributions which are made in addition to compulsory contributions, where such withdrawals do not affect an employee's participation in the plan, the employer's past or future contributions on behalf of such employee, or the basic benefits provided by both the participant's and employer's nonwithdrawable contributions. See Rev. Rul. 60–323.

(4) *Conversion of Contributory to Noncontributory Plan.*—Where a contributory pension plan is amended to provide for employer contributions only, provision may be made for a refund of employee contributions if

discrimination does not result in favor of employees who are officers, shareholders, supervisors, or highly compensated. See Rev. Rul. 61–79, C.B. 1961–1, 138.

(5) *Increments on Employee Contributions.*—The recognition of an employee's right to withdraw his own contributions carries with it the right to receive any increments actually earned thereon. See Rev. Rul. 60–281 and Rev. Rul. 67–340, C.B. 1967–2, 147. Thus, a qualified pension plan that permits an employee to withdraw his voluntary contributions may permit the employee to withdraw any increments on the withdrawn contributions. See Rev. Rul. 69–277.

(p) PROFIT-SHARING AND STOCK BONUS PLANS OF AFFILIATED COMPANIES.—In the case of a profit-sharing plan, or stock bonus plan in which contributions are determined with reference to profits, of an affiliated group of corporations within the purview of section 1504 of the Code, contributions made by other members of the group for the benefit of employees of a corporation that is prevented from making a contribution because it lacks current or accumulated earnings or profits may be deducted only to the extent and in the manner provided in section 404 (a) (3) (B) of the Code and section 1.404(a)–10 of the regulations. See Rev. Rul. 69–35, C.B. 1969–1, 117.

(q) FEEDER PLAN.—A stock bonus or profit-sharing plan that provides that the funds therein may be used to meet the costs of a pension or annuity plan operated concurrently and covering the same employees, if and when the employer suspends contributions to the latter plan, is generally called a "feeder" plan. Such a plan does not qualify because it relieves the employer from contributing to the pension or annuity plan and, therefore, is not for the exclusive benefit of employees or their beneficiaries. See section 1.401–1(b) (3) of the regulations. An employee who has a vested right under a stock bonus or profit-sharing plan, however, may, if the plan so provides, authorize a transfer of all or a part of his vested interest in order to make up a deficiency in the employer's contribution under the pension or annuity plan. In such a case, the amount transferred is includible in the employee's gross income to the same extent as if such interest had been distributed. See Rev. Rul. 69–295, C.B. 1969–1, 117. It should be observed that a "feeder plan" differs from a "feeder organization," as to which see paragraph (k) (4) hereof and section 502 of the Code which denies exemption under section 501 to an organization that is operated for the primary purpose of carrying on a trade or business for profit even though all of its profits are payable to one or more organizations exempt under section 501.

(r) CONTINGENCY OR SURPLUS RESERVES.—The practice of contributing the full amount of annual premiums under an insured pension plan, without reduction for accumulated dividends and regardless of the amount of the allowable deduction limitation, would result in the creation of a contingency or surplus reserve. If a significant part of a trust fund consists of such a reserve, the plan's qualification could be adversely affected. If the advance funding, however, is minor in relation to the actuarial liability under the plan, if there is no possibility of the reversion of a substantial amount to the employer on termination of the plan, and if the advance funding is exclusively for the benefit of the employees or their beneficiaries, such advance funding would not adversely affect the qualification of the plan. Advance funding does not give rise to a current deduction. Accordingly, the deduction otherwise allowable under section 404(a) of the Code, for any taxable year, to the employer must be reduced by the amount of dividends earned, and interest credited on accumulations thereof, in the current or next preceding taxable year. See Rev. Rul. 60–33, C.B. 1960–1, 152.

(s) VALUATION OF SECURITIES ON INVENTORY DATE.—Any type of qualified plan that provides for distributions in accordance with amounts stated or ascertainable and credited to participants, as in profit-sharing, stock bonus, and trusteed pension plans of the money-purchase type, must provide for a valuation of securities held by the trust, at least once a year, on a specified inventory date, in accordance with a method consistently followed and uniformly applied. The fair market value on the inventory date is to be used for this purpose. The respective accounts of participants are to be adjusted in accordance with the valuation. If, for example, as a result of a valuation on the inventory date, John Doe's account, which previously showed a balance of $1,000, is to be increased by one-tenth of 1 percent of the increase in the value of the trust assets, and such increase is $50,000, his interest is to be increased by $50.

(t) ALLOCATION OF STOCK BONUS AND PROFIT-SHARING FUNDS.—All funds in an exempt stock bonus or profit-sharing trust must be allocated to participants in accordance with a definite formula. Thus, no reserves are to be established by withholding allocations from participants. If suspense accounts are maintained, provision is to be made for ascertaining the respective shares of participants in such accounts and such shares are to be included in the distribution.

(u) PLANS PROVIDING FOR LUMP-SUM DISTRIBUTIONS ONLY.—A plan that provides for lump-sum distributions only, but does not contain the basic requisites of a profit-sharing or stock bonus plan, is not a qualified plan under section 401(a) of the Code. A pension plan provides systematically for the payment of definitely determinable benefits to employees over a period of years, usually for life, after retirement. A profit-sharing plan provides for participation in the employer's profits by his employees or their beneficiaries. A stock bonus plan provides benefits similar to those of a profit-sharing plan, except that the contributions by the employer are not necessarily dependent upon profits and the benefits are distributable in stock of the employer corporation. See section

1.401–1(b)(1)(iii) of the regulations. Where, however, a plan provides for employee contributions up to 10 percent of earnings and for employer contributions whether or not it has profits equal to the amounts contributed by the employees, and benefits are paid only in the form of lump-sum cash distributions on retirement or separation from the service for other reasons, the plan is not one within the purview of section 401(a) and, therefore, does not qualify under such section. See Rev. Rul. 62–195, C.B. 1962–2, 125.

PART 3.—IMPOSSIBILITY OF DIVERSION UNDER THE TRUST INSTRUMENT

Section 401(a)(2) of the Internal Revenue Code of 1954—Regulations Section 1.401–2

(a) TRUST INSTRUMENT MUST MAKE PROHIBITED DIVERSION IMPOSSIBLE.—Section 401(a)(2) of the Code requires that under the trust instrument it must be impossible " * * * at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of * * * employees or their beneficiaries * * *." The term "trust instrument" means a written document. Although an oral trust may be recognized under the applicable local law, section 401(a)(2) requires the trust instrument to make the prohibited diversion impossible. The trust instrument must definitely and affirmatively make it impossible for the nonexempt use or diversion to occur. See section 1.401–2(a)(2) of the regulations. The trust must also constitute a valid trust under the law in the jurisdiction to which it is subject. See Rev. Rul. 57–419, C.B. 1957–2, 264, and Rev. Rul. 69–231, C.B. 1969–1, 118.

(b) PAYMENT OF EMPLOYER'S CLAIMS.—A qualified trust may contain a spendthrift clause precluding the use of trust funds for the payment of debts or other obligations of participants and preventing a sale, transfer, or assignment of a participant's interest. It may, however, limit such prohibition so as not to be applicable to indebtedness due the employer. The repayment of a loan owing by an employee is for the economic benefit of the employee since it relieves him of a liability. If a trust did not contain a spendthrift clause so that an employee's creditors could reach his interest, the fund would still be for the exclusive benefit of the employees. Accordingly, the mere fact that the employer is the only one who has that right does not change the result. See Rev. Rul. 56–432, C.B. 1956–2, 284.

(c) CONDITIONAL PAYMENTS.—A provision in a newly established plan for the return of employer contributions only in the event that the Commissioner of Internal Revenue determines that the plan is not qualified does not, of itself, prevent qualification of the plan and exemption of the trust. The plan must be in full force and effect, and the nonreversionary provisions must otherwise prevent the nonexempt use of the funds. It is only by the Commissioner's determination that the plan does not qualify that a recovery of employer contributions made prior to such determination is possible. Under such circumstances, the conditional payment, and the provision therefor, are held not to prevent qualification of the plan and exemption of the trust. See Rev. Rul. 60–276, C.B. 1960–2, 150.

(d) ERRONEOUS ACTUARIAL COMPUTATION.—Trust funds must not be used for purposes other than for the exclusive benefit of employees or their beneficiaries prior to the termination of the trust and the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, and, only then, may recovery be had in the case of a pension trust to the extent of any surplus existing because of an actuarial error. In determining whether any surplus exists on termination of a trust, and the amount thereof, all liabilities, contingent as well as fixed, with respect to employees and their beneficiaries under the trust must be taken into account. Fixed liabilities are the amounts required to provide the benefits payable to those who have become entitled to them. Contingent liabilities are the benefit credits accrued up to the time of termination of the trust for employees (and their beneficiaries) who might have become entitled to benefits if the trust had been continued indefinitely. If such liabilities are to be discharged by commuting the payments (other than through the purchase of insurance company contracts), the value thereof at the time of termination of the trust must be determined for this purpose by use of assumptions no less conservative in any respect than were used in determining costs during the previous life of the trust, and no discount for severances other than death may be assumed.

(e) NO REVERSION IN PROFIT-SHARING OR STOCK BONUS PLANS.—Allocations under profit-sharing and stock bonus plans are not predicated upon amounts actuarially necessary to provide stipulated retirement benefits. See section 1.401–1(b)(1)(i) of the regulations to the effect that a plan designed to provide benefits for employees or their beneficiaries to be paid upon retirement or over a period of years after retirement will, for the purposes of section 401(a) of the Code, be considered a pension plan if the employer contributions under the plan can be determined actuarially on the basis of definitely determinable benefits, or, as in the case of money purchase pension plans, such contributions are fixed without being geared to profits. Consequently, in profit-sharing and stock bonus plans there can be no reversion of any kind since such plans do not provide benefits that are predicated on actuarial assumptions or computations.

(f) APPLICATION OF DIVIDENDS AND OTHER CREDITS UNDER GROUP ANNUITY CONTRACTS.—Provisions analogous to that set forth in section 401(a)(2) of the Code, prohibiting diversion of funds from exempt trusts, are contained in section 404(a)(2) relating to deductions of contributions

under nontrusteed annuity plans, and in section 403(a)(2)(A)(ii) relating to the capital gains treatment for certain distributions under nontrusteed annuity plans. Section 404(a)(2), for example, requires that where retirement annuities are purchased, refunds of premiums, if any, must be applied within the current taxable year or next succeeding taxable year towards the purchase of such retirement annuities. To satisfy this requirement, there must be a definite written arrangement between the employer and the insurer, either as part of the annuity contract or by separate written direction from the employer to the insurer, or partly in one form and partly in the other, providing that.

(1) *Restriction on Payment of Credits or Returns to Employer.*—No credits or returns, other than those arising from corrections of errors in records or computations, such as misstated ages or similar corrections, may be paid to the employer prior to permanent discontinuance of contributions.

(2) *Application of Dividends or Other Returns or Credits.*—All dividends, experience rating credits, or employer surrender or cancellation credits ascertained prior to permanent discontinuance of contributions are to be applied regularly as they are determined toward the premiums next due for purchase of annuities under the plan before any further employer contributions are so applied.

(3) *Surrender or Cancellation Credits After Discontinuance of Plan.*—If surrender or cancellation credits may be made after discontinuance of the plan but before all retirement annuities with respect to service prior to discontinuance of the plan have been purchased, such credits will be applied regularly as they are determined to purchase such retirement annuities by a procedure that does not contravene the conditions of section 401(a)(4).

(4) *Dividends or Experience Credits After Discontinuance of Contributions.*—Any dividends or experience credits similar to dividends made after permanent discontinuance of contributions, or any surrender or cancellation credits made after permanent discontinuance of contributions and after all retirement annuities with respect to service prior to discontinuance of the plan have been purchased, may be paid to the employer provided they are paid as nearly as practicable as they are determined so that no substantial accumulation results. (It may be noted that this possibility of return to the employer after discontinuance is analogous to the provision permitting return to the employer on termination of an exempt pension trust of any surplus arising from erroneous actuarial computations.)

Part 4.—Requirements as to Coverage

Section 401(a) (3), (5), and (6) of the Internal Revenue Code of 1954-Regulations Section 1.401-3

(a) Plan Must Benefit Employees in General.—Section 401(a)(3) of the Code permits an employer to designate several pension, stock bonus, profit-sharing, and annuity plans as constituting parts of a plan that he intends to qualify under that section. If all of the plans so designated cover a sufficient portion of all employees, there is no requirement that a definite share be included in any one plan. The plan, or plans, must benefit employees in general and, towards this end, must cover either a number that 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 a nondiscriminatory classification within the purview of section 401(a)(3)(B). A plan will not necessarily fail to qualify merely because it covers only the employer's one employee, provided, however, that it is not designed or operated as a means of siphoning profits to a shareholder-employee or otherwise limiting participation to an employee within a class in whose favor discrimination is prohibited under section 401(a)(3)(B) and (4) of the Code. See Rev. Rul. 55-81, C.B. 1955-1, 392.

(b) Percentage Coverage Requirements.—The percentage coverage requirements of section 401(a)(3)(A) of the Code may be met by including in the plan a number of employees at least equal to that determined by applying either of the alternative percentage provisions. The percentages are applied after excluding certain short service, seasonal, and part-time employees. For example, if out of a total of 1,200 employees, 100 have less than 3 years of service (the minimum period prescribed by the plan), 25 do not customarily work for more than 20 hours in any one week, and 75 are employees whose customary employment is for not more than 5 months in any calendar year, the percentages are applied to the balance of 1,000. The alternative percentage provisions are: (1) Seventy percent or more of all employees (70 percent of 1,000 in the above example) must be covered under the plan; (2) seventy percent or more of all employees (70 percent of 1,000 in the above example) must be eligible to benefit under the plan, and, if so, at least 80 percent of all eligible employees must actually be covered.

Under the first alternative, on the basis of the figures used, if at least 700 employees are covered, the requirements of section 401(a)(3)(A) are satisfied. Under the second alternative, on the same basis, 700 or more employees must be eligible to participate and at least 80 percent of those eligible must actually participate. For example, if employees are also required to contribute 5 percent of compensation in order to participate, and, say, 750 of them are eligible to do so, then if at least 600 actually do contribute and are covered under the plan, the requirements of section 401(a)(3)(A) of the Code are met. See also the example in section 1.401-3(a)(3) of the regulations.

(c) CLASSIFICATION OF EMPLOYEES.—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 officers, shareholders, supervisors, or highly compensated employees, will satisfy the requirements of section 401(a)(3)(B). Under such section, plans may qualify where coverage is limited to employees who (1) are within a prescribed age group, (2) have been employed for a stated number of years, (3) have been employed in certain designated departments, or (4) are in other classifications, provided that the effect of covering only such employees does not discriminate in favor of employees within the enumerations with respect to which discrimination is prohibited. See section 1.401–3(d) of the regulations and Rev. Rul. 66–12, C.B. 1966–1, 72. The percentage of total employees covered and the percentage of employees in whose favor discrimination is prohibited in relation to total employees participating under a plan are not the sole factors in determining whether a classification meets the nondiscrimination requirements. See Rev. Rul. 68–244, C.B. 1968–1, 158.

(d) IMMEDIATE AND DEFERRED PROFIT-SHARING PLANS.—A profit-sharing plan that is qualified under section 401(a) of the Code is a plan of deferred compensation and, as such, provides for distributing the funds accumulated thereunder after a fixed number of years, the attainment of a stated age, or upon the prior occurrence of some event such as illness, disability, retirement, death, layoff, or severance of employment. See section 1.401–1(b)(1)(ii) of the regulations. Thus, employees who receive the amounts allocated to their accounts before the expiration of such period of time or the occurrence of such contingency are not considered covered under the plan for the purposes of section 401(a)(3)(A) and (B) of the Code. See section 1.401–3(c) of the regulations. If the employee has a right of election to receive his share of the profits in cash or to have it deferred through payment into a trust for his benefit, qualification of the plan is made by reference only to those employees who participate in the trust. See Rev. Rul. 56–497, C.B. 1956–2, 284.

(e) DIFFERENT ELIGIBILITY REQUIREMENTS FOR PRESENT AND FUTURE EMPLOYEES.—A provision for different eligibility requirements for present and future employees is not necessarily discriminatory within the purview of section 401(a)(3)(B) of the Code. If present employees who are officers, shareholders, supervisors, or highly compensated can meet the requirements for new employees there is no objection to the dual requirements. For example, if all present employees regardless of age are eligible and only those new employees who are at least 30 years old may participate, but all present employees who fall within one or more of the categories enumerated in section 401(a)(3)(B) of the Code are at least 30 years of age, the eligibility provision is not objectionable, even though there are other present employees who are under 30 years of age. Similarly, if all present employees are eligible regardless of years of service but only those future employees who will complete five years of service will be eligible, but all present employees who are officers, shareholders, supervisors, or highly compensated have at least five years of service, although there are other present employees who have less than five years, the eligibility provision is acceptable. If, however, in the above illustrations, there are employees within the enumerated categories who are under 30 years of age or have less than five years of service, the prohibited discrimination is likely to arise in operation when new employees are added, and, therefore, in such a case such a provision would not be acceptable as a basis for a favorable advance determination letter.

(f) CONTINUING PARTICIPATION IN THE EVENT OF LEAVE OF ABSENCE.—Plans may provide for continued participation in the event of leave of absence for a specified purpose, such as service in the Armed Forces, sickness, or disability. All participants under similar circumstances, however, must be treated alike. See section 1.401–1(b)(4) of the regulations and Rev. Rul. 69–38, C.B. 1969–1, 131.

(g) BURDENSOME CONTRIBUTIONS.—Section 1.401–3(d) of the regulations provides in part: "* * * if a contributory plan is offered to all of the employees, but the contributions required of the employee participants are so burdensome as to make the plan acceptable only to the highly paid employees, the classification will be considered discriminatory in favor of such highly paid employees." For example, if the plan requires employee contributions of 10 percent of compensation, it will be necessary to determine whether lower paid employees are kept out of the plan because of such requirement. If it is found that lower paid employees are not participating because of the contribution requirement, the classification may be held to discriminate in favor of a group enumerated in section 401(a)(3)(B) and (4) of the Code. Generally, however, employee contributions of six percent or less are not deemed to be burdensome. In cases where the plan provides for optional rates of contribution by employees, and employer contributions or the benefits are geared to the employee contributions in such a way that a higher rate of employee contributions will result in larger benefits from employer contributions, the employee contributions may similarly be found to be burdensome and to result in discrimination in contributions or benefits in contravention of section 401(a)(4) of the Code, but generally only if the highest rate of employee contribution permitted is in excess of six percent of compensation. The test is whether the contribution provisions operate to deprive lower paid em-

ployees of benefits at least as high in proportion to compensation as are provided for higher paid employees, after taking into account differentials permitted under the requirements for integration with social security benefits. See subparagraph (j) below.

(h) VOLUNTARY CONTRIBUTIONS.—Where employees are permitted to make voluntary contributions to which employer contributions are not geared, a potential disproportionate allocation of employer contributions is not present. Such voluntary contributions, however, must be kept within reasonable bounds. Accordingly, provisions may be made for voluntary employee contributions of amounts up to 10 percent of compensation, provided that employer contributions, or the benefits derived therefrom, are not geared to employee contributions which must be used to provide additional benefits only for the individual contributing employee. See Rev. Rul. 59–185, C.B. 1959–1, 86, and Rev. Rul. 69–217, C.B. 1969–1, 115.

(i) CLASSIFICATION WITHIN PURVIEW OF STATUTE BUT DISCRIMINATORY IN OPERATION.—A classification may appear to be satisfactory on paper but if in actual operation of the plan it discriminates in favor of employees who are highly compensated, etc., the plan will fail to qualify. For example, a plan ostensibly covers all employees regardless of service but nonforfeitable rights are provided only for those who have at least 15 years of service and stay on until the normal retirement age of 65. Except for a handful of executives who are shareholders and officers, employees are migratory workers who stay on the job for a relatively short time and then move elsewhere. Although the coverage provisions on paper seem satisfactory, in actual operation only the executive employees will benefit. Accordingly, both paragraphs (3)(B) and (4) of section 401 (a) of the Code are considered together in determining whether the requirements of each are met. It is possible in the illustration used that the plan may qualify if satisfactory provisions for vesting are incorporated therein. See part 5(c) hereof. In the case of a profit-sharing plan under which employees may elect to receive their shares in cash or to participate in a trust, the trust must include enough lower paid employees to demonstrate that in the operation of the plan there is no discrimination in favor of higher paid employees. See Rev. Rul. 56–497, C.B. 1956–2, 284.

(j) INTEGRATION.—Plans that exclude employees who earn less than a specified amount or provide proportionately lesser benefits for such employees may qualify if the benefits under the plan integrate with those provided under the Social Security Act or a similar program (e.g. Railroad Retirement Act). The total benefits, inclusive of those under the social security or similar program, are used for comparative purposes. If a plan is properly integrated, a classification that excludes all employees who are compensated below the compensation level used for integration purposes will not be considered discriminatory solely because the contributions or benefits based on that part of excluded remuneration differ from contributions or benefits based on the part of remuneration that is not so excluded. See section 1.401–3(e) of the regulations which establishes the general basis for the integration of pension, annuity, profit-sharing, and stock bonus plans with benefits provided under the Social Security Act or similar program.

(1) *Integration With OASI Benefits.*—Revenue Ruling 69–4, C.B. 1969–1, 118, provides guides for the integration of pension, annuity, profit-sharing, and stock bonus plans with old-age and survivors insurance benefits provided under the Social Security Act. Section 14.03 of that Revenue Ruling provides that an integrated profit-sharing or stock bonus plan may provide benefits only upon retirement, death, or other separation from service. However, that provision does not preclude such a plan from providing death benefits, by the purchase of life insurance or otherwise. See Rev. Rul. 68–299 C.B. 1968–1, 157.

(2) *Integration Of Disability Benefits.*—Revenue Ruling 69–5, C.B. 1969–1, 125, provides guides for the integration of disability benefits provided under an integrated pension or annuity plan with disability benefits under the Social Security Act.

(3) *Integration With Railroad Retirement Act Benefits.*—Revenue Ruling 12 C.B. 1953–1, 290, and Revenue Ruling 61–147, C.B. 1961–2, 102, provide guides for integrating benefits under pension or annuity plans with those provided by the Railroad Retirement Act. Interim guides for issuing advance determination letters on pension and annuity plans designed to integrate with benefits provided by the Railroad Retirement Act, as amended through 1965, are set forth in Revenue Ruling 67–261, C.B. 1967–2, 148.

(4) *Integration With Benefits Provided Under Other Public Programs.*—Benefits provided under a pension, annuity, profit-sharing, or stock bonus plan may be integrated with those provided under a state or Federal program that, like the social security program, requires employer contributions and makes benefits available to the general public. Thus, benefits payable under a state workmen's compensation law or an occupational diseases law may be an acceptable offset against benefits payable under a qualified plan. However, benefits payable under a qualified plan may not be offset by disability damages recovered by an employee in a common law action against the employer. See Rev. Rul. 68–243, C.B. 1968–1, 157.

(5) *Integration Under Plans Covering Self-Employed Individuals.*—Separate rules apply to integrated plans that provide contributions or benefits for self-employed individuals. For such rules see sections 1.401–11(c) and 1.401–12(h) of the regulations.

(k) VARIABLE BENEFITS UNDER INTEGRATED PLANS.—A pension plan

(other than a money-purchase plan) that covers only employees earning in excess of a specified amount, or under which benefits are offset by all or part of the primary social security benefit, and under which excess earnings are used to provide additional benefits for participants, will not meet the integration requirements unless the plan contains proper limitations on the amount of excess earnings that may be credited to a participant's account, or proper limitations on the amount of benefit provided thereunder. See section 17 of Revenue Ruling 69–4.

(l) COVERAGE LIMITED TO EMPLOYEES EXEMPT FROM OVERTIME PAY PROVISIONS OF THE FAIR LABOR STANDARDS ACT.—A classification that consists only of exmployees who are exempt from the overtime provisions of the Fair Labor Standards Act is not automatically nondiscriminatory. Such a classification may be acceptable in a particular case if it either includes enough employees to satisfy the percentage coverage requirements or if it in fact does not discriminate in favor of employees within the enumerations with respect to which discrimination is prohibited. Section 13(a) of the Fair Labor Standards Act, as amended, 29 USC 213(a), provides that the overtime pay provisions shall not apply to certain employees including an employee who is employed in a bona fide executive, administrative, professional, or local retailing capacity, or in the capacity of outside salesman, as such terms are defined and delineated by regulations of the Wage and Hour Division of the Department of Labor. These regulations provide minimum compensation levels for employees within the prescribed categories. Hence, a plan covering only such employees which has the effect of covering substantially only salaried and clerical employees earning above a certain minimum compensation level must satisfy the integration requirements in order to qualify. See subpart (j) hereof. Furthermore, the classification may be found to be discriminatory if it consists primarily of employees who are officers, shareholders, supervisors, or highly compensated, or if there are relatively many salaried or clerical employees earning in excess of the specified compensation levels who are not exempt from the overtime provisions of the Fair Labor Standards Act and are therefore excluded from the plan. See Rev. Rul. 59–14, C.B. 1959–1, 84.

(m) COVERAGE LIMITED TO SALARIED AND CLERICAL EMPLOYEES.—Section 401(a)(5) of the Code provides that a classification shall not be considered discriminatory within the meaning of section 401(a)(3)(B) merely because it is limited to salaried or clerical employees. Where such a classification does not result in discrimination on behalf of employees in whose favor discrimination is prohibited 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. Rev. Rul. 66–12, C.B. 1966–1, 72, as clarified by Rev. Rul. 68–244, C.B. 1968–1, 158. On the other hand, where limitation of coverage to salaried or clerical employees results in covering primarily employees who are officers, shareholders, supervisors, or highly compensated, to the exclusion of lower-paid, hourly-rated employees, the plan will fail to qualify. The fact that the hourly-rated employees are union members does not, of itself, make the salaried classification nondiscriminatory. See Rev. Rul. 66–14, C.B. 1966–1, 75. See also Rev. Rul. 66–13, C.B. 1966–1, 73. Further, where the salaried plan, when considered by itself, does not meet the coverage requirements of section 401(a)(3)(B) of the Code, the plan will not qualify merely because the employer makes contributions on behalf of the hourly-rated employees, if the contributions or benefits under the plan for the hourly-rated employees are not comparable to those provided for the highly compensated salaried employees. See Rev. Rul. 66–15, C.B. 1966–1, 83.

(n) COVERAGE REQUIREMENTS MUST BE MET ON AT LEAST ONE DAY IN EACH QUARTER.—The coverage requirements of section 401(a)(3) of the Code, either on the percentage basis under section 401(a)(3)(A) or on the basis of a nondiscriminatory classification under section 401(a)(3)(B), may be satisfied for an entire taxable year if such requirements are met on at least one day in each quarter of the taxable year. See section 401(a)(6) of the Code and 1.401–3(g) of the regulations. For example, assuming that returns are filed on a calendar year basis, if the percentage basis is applicable and on the first day of the taxable year 1,000 employees have at least the minimum service requirements prescribed by section 401(a)(3)(A) of the Code, it is sufficient if not less than 700 employees are eligible to participate and not less than 80 percent of those eligible are actually participating on that day even though employee turnover changes the percentages to less than 70 and 80 on all other days prior to April 1 of the same year. The percentage requirements will again have to be met on at least one day during the quarter commencing with April 1, and so on for the other quarters during the year.

(o) DENIAL OF PARTICIPATION FOR FAILURE TO ENTER PLAN UPON BECOMING ELIGIBLE.—Plans may provide for denial of participation for failure to enter the plan upon becoming eligible provided that participation requires something substantially more than mere consent on the part of the employee. For example, under an employee contributory plan, if an employee refuses to sign a prescribed form for participation authorizing salary deductions in accordance with the plan, the plan may provide for the denial of participation at any other time or for a limited time. Similarly, under an insured plan that requires a physical examination and information as to condition of health, the plan

may provide that refusal to take the examination or furnish the information will bar the employee from participation. Adequate notice, however, must be given the employee and the consequences of his failure to comply must be clearly presented to him after which, if he refuses to join, the exclusion provisions of the plan become operative as to such employee. Such provisions must be uniformly applied so as not to result in the prohibited discrimination.

(p) REENTRY INTO PLAN AFTER DISCONTINUANCE OF PARTICIPATION.—Plans may provide for reentry after discontinuance of original participation upon severance of employment or for other reasons, such as failure to continue contributions on the part of the employee. Such provisions, however, must be uniformly applied and in no event should they permit a duplication of benefits.

(q) DELAY IN PURCHASING INSURANCE CONTRACTS.—Generally, a statement in a plan exonerating the trustee from liability in the event of a reasonable delay in the purchase of insurance contracts for participants will not adversely affect the qualification of the plan, provided, however, that the benefits are calculated from the effective date of participation.

(r) EMPLOYEES OF MORE THAN ONE EMPLOYER.—In the case of a pension plan maintained by more than one employer, where employees covered by the plan may receive compensation from more than one of the participating employers, the aggregate compensation may be used in determining the employee's eligibility for benefits in the plan. See Rev. Rul. 55–276, C.B. 1955–1, 401.

(s) PAST SERVICE WITH FORMER EMPLOYERS.—Past service with former employers may be used for the purpose of determining eligibility to participate in a qualified employees' pension plan of a present employer and for determining benefits thereunder, provided (1) such former employer, if not a participant in a group plan with the present employer, is specified in the plan or trust; (2) all employees having such past service are treated uniformly; (3) the use of such past service factor does not produce discrimination in favor of employees who are officers, shareholders, supervisors, or highly compensated, and (4) there is no duplication of benefits. See also sections 1.401–10(b)(4) and 1.401–12(e)(2)(iii) of the regulations with respect to past service under a plan that provides benefits for self-employed individuals. Although the plan may satisfy the nondiscrimination requirements of section 401(a) of the Code, deductions for employer contributions thereunder still have to qualify as ordinary and necessary business expenses and constitute reasonable compensation, as required by section 162(a)(1) of the Code. See Rev. Rul. 62–139, C.B. 1962–2, 123.

PART 5.—DISCRIMINATION IN CONTRIBUTIONS OR BENEFITS

Section 401(a)(4) of the Internal Revenue Code of 1954—Regulations Section 1.401–4

(a) NONDISCRIMINATORY CONTRIBUTIONS OR BENEFITS.—One of the requirements for qualification of a plan is that there must be no discrimination in contributions or benefits in favor of employees who are officers, shareholders, supervisors, or highly compensated, as against other employees whether within or without the plan. See section 1.401–4(a)(1)(i) of the regulations. Thus, for example, a profit-sharing plan which provides for allocations of employer contributions among participants to the extent of 20 percent of compensation for highly compensated employees, and but 10 percent for all others, is discriminatory within the purview of section 401(a)(4) of the Code. See Rev. Rul. 69–158, C.B. 1969–1, 126. Similar considerations apply to pension and annuity plans. However, differences in favor of higher paid employees may be acceptable if the plan is satisfactorily integrated with the benefits provided under the Social Security Act or similar public retirement program. See part 4(j) hereof. Also, as provided in section 1.401–4(a)(1)(ii) of the regulations, any amount allocated to an employee that is withdrawn before the expiration of the time or the occurrence of an event specified in section 1.401–1(b)(1)(ii) of the regulations is not considered in determining whether the contributions under the plan discriminate in favor of employees who are officers, etc. See Rev. Rul. 56–497, C.B. 1956–2, 284. A pension plan that meets the coverage requirements of section 401(a)(3)(A) of the Code for a taxable year is not discriminatory, for that taxable year, merely because it fails to provide benefits for ineligible employees. See Rev. Rul. 68–301, C.B. 1968–1, 161.

(b) VARIATIONS IN CONTRIBUTIONS OR BENEFITS.—Variations in contributions or benefits may be provided so long as the plan, viewed as a whole for the benefit of employees in general, with all its attendant circumstances, does not discriminate in favor of employees who are officers, etc. See section 1.401–4(a)(2)(iii) of the regulations. In some cases benefits under a money purchase pension plan or a profit-sharing plan may vary by reason of an allocation formula that takes into consideration years of service. See Rev. Rul. 68–652, C.B. 1968–2, 176; Rev. Rul. 68–653, C.B. 1968–2, 177; Rev. Rul. 68–654, C.B. 1968–2, 179; and Rev. Rul. 68–592, C.B. 1968–2, 166. While the situation described in Revenue Ruling 68–653 illustrates the result in a case under which the addition of units of compensation and units of service did not result in the prohibited discrimination, and Revenue Ruling 68–654 illustrates a case in which the multiplication of units of compensation by units of service resulted in such discrimination, it was not intended to imply by those rulings that any formula using the addition approach is automatically acceptable and that any formula using the multiplication method is basically discriminatory. The result of the operation of the formula is controlling in each case. If the application of any type of formula results in the

prohibited discrimination, as measured by the ratio of benefits to compensation, the formula is not acceptable. See also Rev. Rul. 57–77, C.B. 1957–1, 158. Thus, a pension or profit-sharing plan will not qualify if contributions and benefits for rank-and-file employees are based solely on compensation while those for officer-employees are based on compensation plus credits under an unfunded arrangement to pay them additional amounts at a later date. See Rev. Rul. 68–454, C.B. 1968–2, 164. Compare Revenue Ruling 69–145, C.B. 1969–1, 126, however, where basing benefits on compensation plus credits under an unfunded arrangement did not result in prohibited discrimination.

(c) VESTED RIGHTS.—Various provisions are in use, ranging from complete and immediate vesting through different forms of graduated vesting (upon completion of stated service or participation requirements and/or reaching a specified age) to no vesting until attainment of normal or stated retirement age. Full vesting of an employee's interest is then required. See subparagraph (1) hereof. Full vesting is also required upon termination of a plan or upon the complete discontinuance of contributions thereunder. See section 401(a)(7) of the Code and part 6 hereof.

(1) *Factual Determination.*—A determination as to satisfactory vesting provisions will of necessity depend on the facts in a particular case. For example, where a company with a large employee turnover experience establishes a plan covering all employees, but provides no vested rights prior to normal retirement, the discriminatory situation described in part 4(i) hereof may result. Accordingly, an advance favorable determination as to the qualification of such plan is not warranted. The situation may be remedied, however, by a provision for fully vested rights after a reasonable waiting period. See Rev. Rul. 68–302, C.B. 1968–1, 163.

(2) *Vesting on Retirement.*—A plan will not be held to qualify if it fails to provide that an employee who has reached the normal retirement age (in the case of a pension or annuity plan) or the stated age or other specified event has transpired (in the case of a profit-sharing or stock bonus plan) and has satisfied any reasonable and uniformly applicable requirements as to length of service or participation, is vested in the contributions made or benefits payable under the plan. See Rev. Rul. 66–11, C.B. 1966–1, 71, and Rev. Rul. 68–302.

(3) *Discontinuance for Cause.*—A qualified plan may provide (a) for discontinuance of benefits to a retired employee for cause which must be distinctly specified (such as, for example, taking a position with a competitor of the employer or divulging the employer's trade secrets to competitors) or (b) for the suspension of benefits for any period of time during which primary insurance benefits under the Social Security Act are discontinued because of employment after retirement. See Rev. Rul. 82, C.B. 1953–1, 288. Similarly, provision may be made for the granting of less liberal rights under such circumstances. Whatever provisions are made, however, must not discriminate in favor of employees who are officers, shareholders, supervisors, or highly compensated. Furthermore, such provisions cannot cause the loss of an employee's benefits after the plan has been terminated or employer contributions thereunder have been discontinued. See section 401(a)(7) of the Code.

(d) TOPHEAVINESS.—Section 401(a)(5) of the Code provides, in part, that a plan shall not be considered discriminatory within the meaning of section 401(a)(3)(B) or (4) merely because the contributions or benefits of or on behalf of the employees under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of such employees. However, in the case of pension and annuity plans that are based on a salary classification, i.e., exclusion of employees earning less than a specified amount, the benefits under the plan must integrate with those provided under the Social Security Act or similar public retirement plan. See part 4(j) hereof. If under the benefit formula of a pension or annuity plan benefits are provided that bear a uniform relationship to compensation, or that do not discriminate in favor of the group with respect to which discrimination is prohibited when social security or similar Federal or State retirement benefits are taken into account, the benefits and contributions are not discriminatory provided, however, that the plan contains the safeguards required by the termination rule set forth in section 1.401–4(c) of the regulations. See subpart (e) below. A pension or annuity plan that is not in conformance with the foregoing requirements does not comply with section 401(a)(4) of the Code with respect to nondiscrimination as to contributions or benefits. A ceiling or similar limitation on the amount of benefits is not required, however, in view of the provisions of section 401(a)(5) of the Code, but a plan under which benefits are limited may be satisfactory whereas otherwise certain essential requirements may not be fully met.

(e) NORMAL RETIREMENT AGE.—The normal retirement age in a pension or annuity plan is the lowest age specified in the plan at which the employee has the right to retire without the consent of the employer and receive retirement benefits based on service to date of retirement at the full rate set forth in the plan (i.e., without actuarial or similar reduction because of retirement before some later specified age). Ordinarily, the normal retirement age under pension and annuity plans is 65, the same as under the old-age survivors, and disability insurance provisions of the Social Security Act. A different age may be specified, provided that if it is lower than 65 it represents the age at which employees

customarily retire in the particular company or industry and is not a device to accelerate funding. In profit-sharing or stock bonus plans, where there is a stated retirement age it is merely one of several events that may be designated as fixing the time for making distributions. Since the amount of the distributions is dependent upon profits, there is no definitely stated rate of benefits payable at such age. Consequently, the stated retirement age in a profit-sharing or stock bonus plan does not have the same significance as "normal retirement age" in a pension plan.

(f) OPTIONAL RETIREMENT PRIOR TO NORMAL RETIREMENT AGE.—Any reasonable optional early retirement age will generally be acceptable provided, however, that if the employer's consent is required, the value of the early retirement benefit does not exceed the value of the employee's vested benefits at that time. This requirement was first announced in Revenue Ruling 57–163, part 5(f), C.B. 1957–1, 128, at 149, originally published in I.R.B. 1957–16, 10, on April 22, 1957. Prior to that date, determination letters had been issued on the qualification of plans that provided for early retirement with the employer's consent if it appeared that the prohibited discrimination would not result because of such provision. Such determination letters continue in effect unless and until revoked. See Rev. Rul. 58–151, C.B. 1958–1, 192, as amplified by Rev. Rul. 58–604, C.B. 1958–2, 147. As for provisions in disability and hardship cases, see paragraph (m) hereof. If the optional early retirement age is earlier than 65 (60 for women), and if integration with old-age, survivors', and disability insurance, or with the benefits under the Railroad Retirement Act, is involved (see part 4(j) hereof), the benefits which depend on integration must be appropriately limited. See sections 9 and 10 of Rev. Rul. 69–4, C.B. 1969–1, 118, where integration with OASDI benefits is involved, or paragraph 7 of Rev. Rul. 12, C.B. 1953–1, 290, at 292, and paragraph 10 of Rev. Rul. 61–147, C.B. 1961–2, 102, at 105, where integration with Railroad Retirement Benefits is involved.

(g) PARTICIPATION AFTER NORMAL RETIREMENT AGE.—The normal retirement age is the time from which definitely determinable benefits under a pension plan become fixed and payable. An employee who has reached such age 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 thereunder. Arrangements, however, may be mutually made for continued employment beyond normal retirement age. In such event, provision may be made with respect to the treatment of the pension benefits such as, for example, payment as though the employee had actually retired, deferment to actual retirement without increment for the interval between normal retirement date and actual retirement, or actuarial equivalent on actual retirement of the benefit at normal retirement age. Whatever provisions are made, however, must be uniformly applied to all participants.

(1) *Additional Benefits for Service After Normal Retirement Age.*—Provision may be made for additional benefits on account of service after normal retirement age provided such provision is uniformly applicable to all employees under similar circumstances and does not result in the prohibited discrimination. In a unit-benefit plan, the units may be continued during the time of the extended service and the total computed to the time of actual retirement. Under a money-purchase plan, the regular rate of contributions may continue to actual retirement. Under a fixed-benefit plan the benefits payable at actual retirement may be the actuarial equivalent of those payable at normal retirement age.

(2) *Continued Participation Under a Profit-Sharing or Stock Bonus Plan.*—A provision for continued participation under a profit-sharing or stock bonus plan and for contributions to provide additional benefits for employees who remain in employment beyond the stated age does not adversely affect the qualification of the plan, provided, however, that such provision is uniformly applied to all employees under similar circumstances and does not result in the prohibited discrimination.

(h) BASIS OF COMPENSATION ON WHICH BENEFITS ARE COMPUTED.—Section 401(a)(5) of the Code provides in part: "Neither shall a plan be considered discriminatory * * * merely because the contributions or benefits of or on behalf of the employees under the plan bear a uniform relationship *to the total compensation, or the basic or regular rate of compensation,* of such employees * * *" (Emphasis supplied). Thus, total compensation (which may include bonuses, commissions, or overtime pay), basic compensation, or regular rate of compensation may be used, provided that whatever is used is consistently and uniformly applicable to all participants. See also subpart (b) hereof with respect to variations in contributions or benefits.

(i) IMPUTED COMPENSATION.—Employer contributions under a qualified employees' pension plan on behalf of uncompensated employees, who are also officers, may not be based on imputed compensation for these employees since such treatment would not be consistently and uniformly applicable to all participants and would, therefore, result in the prohibited discrimination. See Rev. Rul. 62–206, C.B. 1962–2, 129.

(j) FINAL PAY PLANS.—Section 1.401–1(b)(3) of the regulations provides in part: "* * * a plan is not for the exclusive benefit of employees in general if, by any device whatever, it discriminates either in eligibility requirements, contributions, or benefits in favor of employees who are officers, shareholders, persons whose principal

duties consist in supervising the work of other employees, or the highly compensated employees. See section 401(a)(3), (4), and (5)." Thus, benefits computed at a uniform rate of compensation for all participants may be nondiscriminatory but if compensation is adjusted to favor one or a select few the plan may become discriminatory in operation. See section 401(a)(5) of the Code. For example, under a 50 percent fixed benefit plan, a $10,000-a-year officer who fulfills all requirements for retirement would be entitled to an annuity of $5,000, but if shortly before retirement his compensation is increased to $20,000 per annum his retirement annuity, computed on final salary, would be $10,000, or 100 percent of compensation before the increase, whereas others would only be receiving 50 percent. Section 1.401–1(b)(3) of the regulations also points out: "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." Accordingly, in any case where increases in compensation during the last 5 years of employment are taken into account for the purpose of computing benefits, provision is generally made that such benefits are to be based on compensation averaged over a period of at least 5 years. In a pension plan which provides both past and future service credits the past service credits may be computed on the average compensation for the 5-year period immediately preceding the establishment of the plan.

(k) Adjustment of Benefits Due to Increases or Decreases in Compensation.—Consistent and uniform bases of compensation for determining benefits under a plan are essential in order to preclude the prohibited discrimination. If benefits are based on compensation at the time the plan is established, and if certain highly compensated employees are within a few years of retirement, their benefits will be based on the highest, or nearly the highest, compensation, while lower paid employees who entered the service of the employer shortly before the plan was established will receive benefits based on the lowest, or nearly the lowest, compensation. To eliminate discrimination, a consistent and uniform application should prevail as between both groups, e.g., where compensation within a few years before retirement that includes salary increments since original employment is used for the highly compensated employees, similar compensation should be used for the lower paid employees. Therefore, provision is to be made for increases in benefits when compensation on which benefits are computed is increased. See Rev. Rul. 69–251, C.B. 1969–1, 127. Plans may also provide for decreases in benefits because of decreases in compensation but since the aforesaid result is not present such provision is not required.

(l) Discretion as to Payment of Benefits Under Basic Options.—Plans may include various modes of settlement for payment of benefits if under each mode the distribution has the same value as a distribution determined under any other mode of settlement provided for under the plan, and if, upon retirement (or event calling for a distribution in a profit-sharing plan), each participant is entitled to a fully vested right in the amount which has been accumulated for his benefit. In an insured plan, any type of benefit that is provided under the options contained in the insurance contract is the actuarial equivalent of any other option. Consequently, discretion in the trustee to determine under which option benefits will be paid does not result in the prohibited discrimination. Similarly, discretion may be provided for in a profit-sharing plan which, for example, permits the trustee to determine whether lump-sum or periodic distributions are to be made in particular cases. The amounts distributable must be fully vested in the employees in either situation, and, if periodic distributions are to be made to some as against lump-sum payments to others, the present value of all such periodic amounts payable to any employee is to be equal to the immediate lump-sum otherwise distributable to him.

(m) Provisions for Disability and Hardship Cases.—Pension plans may contain provisions for early retirement because of disability provided that the term "disability" is defined and the rules with respect thereto are uniformly and consistently applied to all employees in similar circumstances. Provisions may also be made in stock bonus and profit-sharing plans for accelerated distributions because of hardship provided that the term "hardship" is defined, the rules with respect thereto are uniformly and consistently applied, and the distributable portion does not exceed the employee's vested interest. Similar provisions, however, are not permissible under a pension plan, since, as provided for in section 1.401–1(b)(1)(i) of the regulations, such a plan is established and maintained "primarily to provide systematically for the payment of definitely determinable benefits to * * * employees over a period of years, usually for life, after retirement." See Rev. Rul. 56–693, C.B 1956–2, 282, as modified by Rev. Rul. 60–323, C.B. 1960–2, 148.

(n) Provision That Benefits be Based on Cash Surrender Value in Insured Plans.—If an insured plan provides that benefits shall be based on cash surrender values, all contracts purchased must provide uniform cash surrender value with respect to all employees under similar circumstances.

(o) Loan Privileges.—Provision may be made for granting loans to participants provided the loans are granted in a uniform and nondiscrimi-

natory manner. The qualification of a plan will not be affected by a provision in the trust instrument that adequately secured loans bearing a reasonable rate of interest and providing for repayment within a specified period of time may be granted to employee-participants even though such loans may be in amounts exceeding their vested interests. See Rev. Rul. 67–288, C.B. 1967–2, 151. However, "so-called" loans may constitute "distributions" if there is a tacit understanding between the parties that collection is not intended or if, for some other reason, the transaction does not create a debtor-creditor relation. See Rev. Rul. 67–258, C.B. 1967–2, 68.

(p) PAST SERVICE BENEFITS IN PLANS THAT CONTAIN A MINIMUM AGE OR SERVICE REQUIREMENT FOR ELIGIBILITY.—A plan that contains a minimum age or service requirement for eligibility and provides for past service credits for all prior service of original, but not subsequent, participants will generally be considered objectionable within the purview of section 401(a)(3)(B) and (4) of the Code unless it can be demonstrated that such credits do not result in the prohibited discrimination. Where the difference is only one year, however, e.g., if there is a one year waiting period for eligibility, but original participants are given credit for all prior service, including the one year waiting period, and new participants do not receive credit based on the one year, such a provision may be acceptable. Provision may also be made for credits on account of past services rendered after attainment of a specified age or completion of minimum service, if applied to original as well as subsequent participants.

(q) RIGHT OF TRUSTEE TO BORROW ON INSURANCE CONTRACTS.—Provision may be made granting the trustee the right to borrow against the loan values of insurance contracts, provided, however, that in doing so the remaining interest of employees who are officers, etc., is proportionately no greater than the interest of other employees.

(r) EARMARKED INVESTMENTS.—Where amounts to be distributed to participants under an employees' trust are measured by investments that have been earmarked for their respective accounts, the trustee is to invest each participant's interest proportionately, unless all participants have the right to direct the trustee to select the type of investment with respect to their individual shares.

PART 6.—TERMINATION OF A QUALIFIED PLAN

Section 401(a)(7) of the Internal Revenue Code of 1954—Regulations Sections 1.401–4(c) and 1.401–6

(a) EMPLOYEES' RIGHTS ON TERMINATION OF PLAN.—A qualified plan must expressly provide that upon its termination, or complete discontinuance of contributions thereunder, the rights of each employee to benefits accrued to the date of such termination or discontinuance, to the extent then funded, or the rights of each employee to the amounts credited to his account at such time, are nonforfeitable. See section 1.401–6(a)(1) of the regulations. The failure of an otherwise qualified plan to specifically provide in the first year of the plan that employees' rights to benefits will become nonforfeitable upon discontinuance of contributions does not prevent the plan from meeting the requirements of section 401(a) of the Code where the employer makes the first year's contributions, required to bring the plan into existence, provided the necessary provision is added by amendment during the second year of the plan's existence. See Rev. Rul. 68–137, C.B. 1968–1, 164. A qualified pension or annuity plan must generally include limitations on benefits to certain highly paid employees in accordance with the termination rule set forth in section 1.401–4(c) of the regulations. See subpart (c) hereof.

(b) PROVISION FOR ALLOCATION OF UNALLOTTED FUNDS.—Provision must also be made for the allocation of any previously unallocated funds to participating employees upon termination of the plan or complete discontinuance of contributions. Any provision for allocation is acceptable if it (1) specifies the method to be used, (2) does not discriminate in favor of employees enumerated in section 401(a)(4) of the Code, and (3) is not in conflict with the restrictions set forth in section 1.401–4(c) of the regulations as to compliance with the "termination rule." See subpart (c) hereof. The allocation of funds may be in cash or in the form of other benefits provided under the plan. The allocation of funds contributed by the employer among the employees, however, need not necessarily benefit all covered employees. For example, an allocation may be satisfactory if priority is given to benefits for employees over the age of 50 at the time of termination of the plan, or those who then have at least 10 years of service, or those who meet both such age and service requirements, provided, however, that there is no possibility of discrimination in favor of employees who are officers, shareholders, supervisors, or highly compensated. See section 1.401–6(a)(2) of the regulations. Similarly, if the prohibited discrimination does not result, the funds may be used, for example, to continue benefits first to retired employees, then for employees who have met the requirements for retirement but have not yet retired, then for employees over age 60, and so on down to younger groups, until the funds are fully exhausted.

(c) TERMINATION RULE.—If benefits for employees who are officers, etc., 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 discrimina-

tion 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. Guides for applying the termination rule are set forth in Rev. Rul. 55–60, C.B. 1955–1, 37; Rev. Rul. 61–10, C.B. 1961–1, 143; Rev. Rul. 65–294, C.B. 1965–2, 136; Rev. Rul. 67–114, C.B. 1967–1, 85; and Rev. Rul. 67–213, C.B. 1967–2, 149. A provision for restriction on distributions to the 25 highest paid employees is not acceptable if the trustee is to act only after notificatiton by the employer. See Rev. Rul. 66–176, C.B. 1966–1, 85. The termination rule contained in section 1.401–4(c) of the regulations is not applicable to profit-sharing and stock bonus plans since acceptable allocation formulae under such plans are designed to preclude the prohibited discrimination under comparable circumstances. The requirements pertaining to permanency, however, are applicable to all types of plans. See part 2(h) hereof.

(d) Discontinuance or Suspension of Contributions and Curtailments.—A discontinuance of contributions is similar to a termination of the plan in that employees who become eligible to enter the plan subsequent to the discontinuance receive no benefits and no additional benefits, attributable to employer contributions, accrue to any of the participants unless contributions are resumed. The same requisites that apply to a termination of a plan are, therefore, equally applicable to a discontinuance. In such case, vesting of employees' rights is required. See subpart (a) hereof and Rev. Rul. 55–186, C.B. 1955–1, 39, as modified by Rev. Rul. 56–596, C.B. 1956–2, 288. See part 2(h) hereof, however, with respect to the effect on continued exemption of the trust where contributions are discontinued for a valid business reason.

(1) *Suspensions.*—A suspension is a temporary cessation of contributions which may ripen into a discontinuance. In the case of a pension or annuity plan, however, a suspension of contributions will not necessarily require vesting of employees' rights merely because of the existence of such situation, and the applicability of a prior ruling as to the qualification of the plan under section 401(a) of the Code will not be adversely affected by the suspension if the following conditions are met, namely: (1) The benefits to be paid or made available under the plan are not affected at any time by the suspension, and (2) the unfunded past service cost at any time (which includes any unfunded prior normal cost and unfunded interest on any unfunded cost) does not exceed the unfunded past service cost as of the date of establishment of the plan (plus any additional past service or supplemental costs added by amendment). See Rev. Rul. 56–596. In the case of a profit-sharing plan, contributions must be recurring and substantial. See section 1.401–1(b)(2) of the regulations. A determination as to whether a suspension of contributions under a profit-sharing plan constitutes a discontinuance will be made upon consideration of the facts and circumstances of the partciular case. For factors in determining whether a suspension of contributions under a profit-sharing plan constitutes a discontinuance, see Rev. Rul. 60–2, C.B. 1960–1, 164.

(2) *Reservation To Suspend Contributions Under a Profit-Sharing Plan.*—If, under the terms of a profit-sharing plan, authority is specifically reserved to discontinue contributions without terminating the trust, the plan must also contain an appropriate provision granting fully vested rights to participants upon discontinuance of contributions by the employer. The situation is similar to a case in which actual termination of the trust occurs. See Rev. Rul. 56–596.

(3) *Curtailments.*—Where a plan that requires employee contributions is amended so as to make it noncontributory, and provision is also made for a refund of employee contributions, the plan is curtailed but its status for qualification is thereby not adversely affected if the prohibited discrimination does not result. See Rev. Rul. 61–79, C.B. 1961–1, 138, amplifying Rev. Rul. 55–14, C.B. 1955–1, 302.

Part 7.—Application of Forfeitures

Section 401(a)(8) of the Internal Revenue Code of 1954—Regulations Section 1.401–7

(a) Forfeitures Under Pension Plans.—A qualified pension plan must provide that forfeitures arising from severance of employment, death, or for any other reason, must not be applied to increase the benefits any employee would otherwise receive under the plan at any time prior to the termination of the plan or the complete discontinuance of employer contributions thereunder. See section 401(a)(8) of the Code. The amounts forfeited must be used as soon as possible to reduce the employer's contributions under the plan. See section 1.401–1(b)(1)(i) and 1.401–7 of the regulations and Part 2(m) hereof. See Rev. Rul. 67–68, C.B. 1967–1, 86, for some examples of plan provisions that satisfy the requirements of section 401(a)(8) of the Code.

(b) Forfeitures Under Profit-Sharing and Stock Bonus Plans.—Provision may be made in profit-sharing and stock bonus plans that forfeitures be used to reduce employer contributions that otherwise would be required under the contribution formula contained in the plan. Although such application is not mandatory, whatever provision is made must not result in prohibited discrimination.

APPENDIX

Revenue Rulings cited in this compendium

Revenue Ruling number	Cumulative Bulletin reference	Content and subsequent action, if any	Part of this revenue ruling in which cited
12.....	1953–1, 290....	Integration with benefits under Railroad Retirement Act as amended through October 1951; extended to cover integration at $4,800 by Rev. Rul. 61–147, C.B. 1961–2, 102.	4(j)(3); 5(f).
33.....	1953–1, 267....	Guides for qualification released in 1953; replaced by Rev. Rul. 57–163, C.B. 1957–1, 128, guides released in 1957; further replaced by Rev. Rul. 61–157, C.B. 1961–2, 67, guides released in 1961; Rev. Rul. 65–178, C.B. 1965–2, 94, guides released in 1965; and this ruling.	1(c).
82.....	1953–1, 288....	Suspension of plan benefits on suspension of Social Security benefits because of postretirement employment.	5(c)(3).
109.....	1953–1, 288....	Forfeitures under money-purchase pension plan may not be used to increase benefits to remaining participants; see also Rev. Rul. 60–73, C.B. 1960–1, 155.	2(m).
185.....	1953–2, 202....	Variable annuities under qualified plan; see also Rev. Rul. 60–337, C.B. 1960–2, 151.	2(m).
54–51.....	1954–1, 147....	Incidental life insurance under profit-sharing plan; amplified by Rev. Rul. 57–213, C.B. 1957–1, 157, and Rev. Rul. 60–84, C.B. 1960–1, 159.	2(n)(2).
54–67.....	1954–1, 149....	Plan funded only with ordinary life insurance contracts does not qualify; see also Rev. Rul. 65–25, C.B. 1965–1, 173.	2(n).
54–152.....	1954–1, 149....	Contributions by employees only to retirement but employer is obligated to pay stipulated benefits after trust funds are exhausted; clarified by Rev. Rul. 66–205, C.B. 1966–2, 119.	2(b).
54–231.....	1954–1, 150....	Two-year deferment of contributions under profit-sharing plan.	2(c).
54–398.....	1954–2, 239....	Designation of beneficiaries.....	2(l).
55–14.....	1955–1, 302....	Contributory feature of plan removed retroactively; amplified by Rev. Rul. 61–79, C.B. 1961–1, 138.	6(d)(3).
55–60.....	1955–1, 37.....	Termination of pension plan after 10-year period of restriction on benefits for 25 highest paid employees.	2(h); 6(c).
55–81.....	1955–1, 392....	Plan covering one individual who is the only employee.	4(a).
55–186.....	1955–1, 39.....	Full vesting on discontinuance of profit-sharing contributions; modified by Rev. Rul. 56–596, C.B. 1956–2, 288.	6(d).
55–276.....	1955–1, 401....	Total compensation from two employers for participation in $3,600 excess plan maintained jointly by both.	4(r).
55–629.....	1955–2, 588....	Plan cannot remain in qualified status when there are no employees eligible to participate.	2(j).

APPENDIX—Continued

Revenue Rulings cited in this compendium

Revenue Ruling number	Cumulative Bulletin reference	Content and subsequent action, if any	Part of this revenue ruling in which cited
55–681.....	1955–2, 585....	Qualification of collectively bargained industry-wide pension plan negotiated for 5-year period.	2(h).
55–748.....	1955–2, 234....	Life insurance proceeds payable to employees' trust.	2(n).
56–23.....	1956–1, 598....	Plan of unincorporated association; modified by Rev. Rul. 57–546, C.B. 1957–2, 886.	2(j)(2).
56–267.....	1956–1, 206....	Qualification of pooled investment trust; distinguished by Rev. Rul. 67–301, C.B. 1967–2, 146; see also Rev. Rul. 66–297, C.B. 1966–2, 234.	2(e)(1).
56–432.....	1956–2, 284....	Preference to employer to employee's interest in plan to pay indebtedness.	3(b).
56–497.....	1956–2, 284....	Cash and trusteed profit-sharing plan.....	4(d); 4(i); 5(a).
56–596.....	1956–2, 288....	Suspension of employer contributions in pension plan; modifies Rev. Rul. 55–186, C.B. 1955–1, 39.	2(h); 6(d); 6(d)(1); 6(d)(2).
56–633.....	1956–2, 279....	Qualification of annuity portion of contract which also includes group term life and accident and health insurance.	2(n).
56–656.....	1956–2, 280....	Plan providing for election to pay beneficiary only does not qualify; see also Rev. Rul. 60–59, C.B. 1960–1, 154.	2(j).
56–673.....	1956–2, 281....	Nontrusteed plan in which employees are owners of insurance contracts not qualified; see also Rev. Rul. 69–231, C.B. 1969–1, 118.	2(f).
56–693.....	1956–2, 282....	Employee withdrawals prior to severance of employment; modified by Rev. Rul. 60–323, C.B. 1960–2, 148.	2(o)(1); 5(m).
57–77.....	1957–1, 158....	Profit-sharing allocations by retirement units; see also Rev. Rul. 68–652, C.B. 1968–2, 176; Rev. Rul. 68–653, C.B. 1968–2, 177; Rev. Rul. 68–654, C.B. 1968–2, 179; and Rev. Rul. 68–592, C.B. 1968–2, 166.	5(b).
57–163.....	1957–1, 128....	Guides for qualification released in 1957; replaced Rev. Rul. 33, C.B. 1953–1, 267; replaced by Rev. Rul. 61–157, C.B. 1961–2, 67; further replaced by Rev. Rul. 65–178, C.B. 1965–2, 94, and this ruling.	1(c); 5(f).
57–213.....	1957–1, 157....	Incidental life insurance under profit-sharing plan; amplifies Rev. Rul. 54–51, C.B. 1954–1, 147; see also Rev. Rul. 60–84, C.B. 1960–1, 159.	2(n)(2).
57–419.....	1957–2, 264....	Trust instrument executed during taxablee year but corpus furnished during grac period in following year.	2(f); 3(a).
57–546.....	1957–2, 886....	Plan of unincorporated association; modifies Rev. Rul. 56–23, C.B. 1956–1, 598.	2(j)(2).
58–151.....	1958–1, 192....	Early retirement with employer's consent; amplified by Rev. Rul. 58–604, C.B. 1958–2, 147.	5(f).

APPENDIX—Continued

Revenue Rulings cited in this compendium

Revenue Ruling number	Cumulative Bulletin reference	Content and subsequent action, if any	Part of this revenue ruling in which cited
58–604.....	1958–2, 147....	Early retirement with employer's consent amplifies Rev. Rul. 58–151, C.B. 1958–1, 192.	5(f)
59–14.....	1959–1, 84.....	Coverage of employees exempt under wage-hour provisions of Fair Labor Standards Act.	4(l)
59–185.....	1959–1, 86.....	Voluntary employee contributions.....	4(h).
59–402.....	1959–2, 122....	Annuity plan in effect.....	2(f).
60–2.....	1960–1, 164....	Suspension of profit-sharing contributions..	6(d)(1).
60–33.....	1960–1, 152....	Accumulation of dividends on insurance contracts.	2(r).
60–59.....	1960–1, 154....	Post retirement death benefits; Rev. Rul. 56–656, C.B. 1956–2, 280, distinguished.	2(n)(1).
60–73.....	1960–1, 155....	Application of forefeitures in money-purchase pension plan; see also Rev. Rul. 109, C.B. 1953–1, 288.	2(m).
60–83.....	1960–1, 157....	Profit-sharing investments in paid-up units of endowment insurance.	2(n)(1).
60–84.....	1960–1, 159....	Incidental life insurance under profit-sharing plan; amplifies Rev. Rul. 54–51, C.B. 1954–1, 147; see also Rev. Rul. 57–213, C.B. 1957–1, 157.	2(n)(2).
60–276.....	1960–2, 150....	Conditioning contributions under new plan on favorable determination letter; supersedes Rev. Rul. 59–309, C.B. 1959–2, 117.	3(c).
60–281.....	1960–2, 146....	Withdrawal of employee contributions and increments thereon on discontinuance of participation.	2(o)(5).
60–323.....	1960–2, 148....	Withdrawal of employee voluntary contributions; see also Rev. Rul. 56–693, C.B. 1956–2, 282.	2(o)(1); 2(o)(3); 5(m).
61–10.....	1961–1, 143....	Lump-sum distributions under plan subject to limitations on benefits for 25 highest paid employees.	6(c).
61–79.....	1961–1, 138....	Conversion of contributory plan by eliminating and refunding employee contributions; amplifies Rev. Rul. 55–14, C.B. 1955–1, 302; amplified by Rev. Rul. 67–340, C.B. 1967–2, 147.	2(o)(4); 6(d)(3).
61–121.....	1961–2, 65.....	Incidental preretirement death benefits under non-insured pension plan.	2(n)(1).
61–147.....	1961–2, 102....	Guides for integrating pension benefits with benefits under Railroad Retirement Act, as amended through 1960; Rev. Rul. 12, C.B. 1953–1, 290, supplemented.	4(j)(3); 5(f).
61–157.....	1961–2, 67.....	Guides for qualification released in 1961; replaced Rev. Rul. 57–163, C.B. 1957–1, 128; replaced by Rev. Rul. 65–178, C.B. 1965–2, 94 and this ruling.	1(c).
61–164.....	1961–2, 99.....	Incidental accident and health insurance under profit-sharing plan.	2(n)(3).
62–139.....	1962–2, 123....	Past service with former employer.....	4(s).
62–195.....	1962–2, 125....	Plan providing lump-sum distributions only, not geared to profits or distributing employer stock, not qualified.	2(u).

APPENDIX—Continued

Revenue Rulings cited in this compendium

Revenue Ruling number	Cumulative Bulletin reference	Content and subsequent action, if any	Part of this revenue ruling in which cited
62–206.....	1962–2, 129....	Imputed compensation for computing benefits adversely affects qualification of plan.	5(i).
63–46.....	1963–1, 85.....	Funding pension benefits by transfer of funds in trust established by third party.	2(g).
63–108.....	1963–1, 87.....	Plan covering sole stockholder-employee only not qualified; see also Rev. Rul. 55–81, C.B. 1955–1, 392.	2(j)(3).
65–25.....	1965–1, 173....	Plan covering self-employed individuals providing only such benefits as are available under ordinary life insurance contracts not qualified. See also Rev. Rul. 54–67, C.B. 1954–1, 149.	2(n).
65–178.....	1965–2, 94.....	Guides for qualification released in 1965; replaced Rev. Rul. 61–157, C.B. 1961–2, 67; replaced by instant ruling.	1(c).
65–294.....	1965–2, 136....	Treatment of excess reserves arising from application of restrictions imposed on benefits of highest paid employees.	6(c).
66–11.....	1966–1, 71.....	Deferral of payment of employee's vested benefit.	5(c)(2).
66–12.....	1966–1, 72.....	Salaried-only pension plan that is not discriminatory; clarified by Rev. Rul. 68–244, C.B. 1968–1, 158.	4(c); 4(m).
66–13.....	1966–1, 73.....	Salaried-only profit-sharing plan that is discriminatory.	4(m).
66–14.....	1966–1, 75.....	Salaried-only profit-sharing plan that is discriminatory even though the hourly employees are unionized and the employer may not unilaterally include them in the plan.	4(m).
66–15.....	1966–1, 83.....	Salaried-only profit-sharing plan that is discriminatory because the percentage of employer contributions for salaried employees exceeds the percentage of employer contributions under a pension plan for hourly employees.	4(m).
66–92.....	1966–1, 77.....	Tax classification of professional service organizations and deferred compensation plans established by such organizations.	2(j)(2).
66–143.....	1966–1, 79.....	Incidential life insurance under a trusteed money-purchase pension plan; clarified by Rev. Rul. 68–31, C.B. 1968–1, 151.	2(n)(1).
66–174.....	1966–1, 81.....	Profit-sharing plan that permits employer contributions to be made out of current profits or accumulated earned surplus regardless of whether there are earnings or profits for Federal income tax purposes.	2(g).
66–175.....	1966–1, 82.....	Voluntary contributions by former employees of employer participating in qualified, multi-employer negotiated pension plan.	2(j).
66–176.....	1966–1, 85.....	Provision in plan that insurer or trustee is obligated to apply restrictions on benefits to highest paid employees only upon notification by employer.	6(c).

APPENDIX—Continued

Revenue Rulings cited in this compendium

Revenue Ruling number	Cumulative Bulletin reference	Content and subsequent action, if any	Part of this revenue ruling in which cited
66–218.....	1966–2, 120....	Inclusion of shareholder-employees in plan established by electing small business corporation.	2(j)(3).
66–297.....	1966–2, 234....	Qualification of pooled investment trust and exemption of common trust fund.	2(e)(1).
67–68.....	1967–1, 86.....	Pension plan provisions that meet the requirements of section 401(a)(8) prohibiting use of forfeitures to increase plan benefits.	7(a).
67–114.....	1967–1, 85.....	Application of limitations imposed on benefits of highest paid employees where a change in a pension or annuity plan increases benefits.	6(c).
67–213.....	1967–2, 149....	Pension plan considered terminated by transfer of assets to trustee of profit-sharing trust.	6(c).
67–258.....	1967–2, 68.....	Inclusion of proceeds representing loan value of annuity contract in gross income of employee when received from insurance company.	5(o).
67–261.....	1967–2, 148....	Guides for integrating benefits under private plans with benefits provided under the Railroad Retirement Act.	4(j)(3).
67–288.....	1967–2, 151....	Qualification of pension plan that permits adequately secured loans in excess of an employee's vested interest.	5(o).
67–301.....	1967–2, 146....	Effect of investing funds of employees' trust in common trust fund; distinguishes Rev. Rul. 56–267, C.B. 1956–1, 206.	2(k)(5).
67–340.....	1967–2, 147....	Return of employee contributions pursuant to amendment that makes plan non-contributory.	2(o)(5).
68–24.....	1968–1, 150....	Withdrawal of employee contributions after five years of participation in a profit-sharing plan.	2(c).
68–25.....	1968–1, 151....	Payment by employer of part or all of contribution otherwise required of employee in a particular year.	2(b).
68–31.....	1968–1, 151....	Incidental death benefits under qualified money purchase pension plan; clarifies Rev. Rul. 66–143, C.B. 1966–1, 79.	2(n)(1).
68–116.....	1968–1, 177....	Use of variable annuity contracts. See also Rev. Rul. 185, C.B. 1953–2, 202.	2(m).
68–137.....	1968–1, 164....	Qualification of pension plan that does not contain express language relating to discontinuance of contributions during its first year of operation.	6(a).
68–159.....	1968–1, 153....	Pension plan that permits trustee to deduct and pay retired employee's union dues from his monthly pension.	2(n).
68–223.....	1968–1, 154....	Transfer of funds from non-exempt employees' welfare fund to qualified employees' trust.	2(g).
68–243.....	1968–1, 157....	Integration of plan benefits with benefits provided under state workmen's compensation and occupational diseases laws.	4(j)(4).

APPENDIX—Continued

Revenue Rulings cited in this compendium

Revenue Ruling number	Cumulative Bulletin reference	Content and subsequent action, if any	Part of this revenue ruling in which cited
68–244.....	1968–1, 158....	Effect of percentage of high paid employees and percentage of total employees covered under salaried-only plan in determining whether plan meets coverage requirements; clarifies Rev. Rul. 66–12, C.B. 1966–1, 72.	4(c); 4(m).
68–299.....	1968–1, 157....	Provision for life insurance under integrated profit-sharing plan; amplifies Rev. Rul. 61–75, C.B. 1961–1, 140; supersedes Rev. Rul. 67–426, C.B. 1967–2, 149.	4(j)(1).
68–301.....	1968–1, 161....	Qualified plan that meets the coverage requirements of section 401(a)(3)(A) need not provide benefits for ineligible employees.	5(a).
68–302.....	1968–1, 163....	Vesting provisions under qualified plans...	5(c)(1).
68–370.....	1968–2, 174....	Meeting coverage and nondiscrimination requirements where corporate employer participates in a partnership or a joint venture that has its own employees.	2(e)(2)
68–453.....	1968–2, 163....	Incidental life insurance benefits under a qualified plan.	2(n)(1).
68–454.....	1968–2, 164....	Use of credits under unfunded nonqualified deferred compensation plan in determining benefits under a qualified pension plan; distinguishes Rev. Rul. 54–13, C.B. 1959–1, 83.	5(b).
68–592.....	1968–2, 166....	Allocation of employer contributions under money purchase pension plan on basis of service as well as compensation.	5(b).
68–651.....	1968–2, 167....	Plan intended to qualify as a profit-sharing plan contains provision to permit employees to make voluntary contributions prior to the time they become eligible to share in the employer's profits.	2(g).
68–652.....	1968–2, 176....	Qualification of employees' profit-sharing plan that contains a years-of-service factor in formula for allocating employer contributions.	5(b).
68–653.....	1968–2, 177....	Profit-sharing formula weighted by years of service through adding compensation and service units.	5(b).
68–654.....	1968–2, 179....	Profit-sharing formula weighted by years of service through multiplying compensation and service units.	5(b).
69–4.....	1969–1, 118....	Guides for integration of retirement benefits provided by pension, annuity, profit-sharing, and stock bonus plans with old age and survivors' insurance benefits provided under the Social Security Act.	4(j)(1); 4(k); 5(f).
69–5.....	1969–1, 125....	Guides for integration of disability benefits provided under pension and annuity plans with disability benefits provided under the Social Security Act.	4(j)(2).
69–24.....	1969–1, 110....	Effect of terminations and curtailments of plans previously held to be qualified; see also Rev. Rul. 55–60, C.B. 1955–1, 37, and Rev. Rul. 69–25, C.B. 1969–1, 113.	2(h).

APPENDIX—Continued

Revenue Rulings cited in this compendium

Revenue Ruling number	Cumulative Bulletin reference	Content and subsequent action, if any	Part of this revenue ruling in which cited
69–25.....	1969–1, 113....	Qualification of plans that are abandoned or discontinued within a few years after they are established; see also Rev. Rul. 69–24, C.B. 1969–1, 110.	2(h).
69–35.....	1969–1, 117....	Allocation of contribution made to the common employees' trust maintained by an affiliated group to employees of an employer other than the employer making the contribution.	2(g); 2(p).
69–65.....	1969–1, 114....	Application of fair return investment requisite to obligatory investment by stock bonus trust in stock of the employer; modifies Rev. Rul. 57–372, C.B. 1957–2, 256.	2(k)(1).
69–144.....	1969–1, 115....	Past service credit for period in which employee was a partner or proprietor of predecessor business.	2(j)(1).
69–157.....	1969–1, 115....	Retention of exempt status for employees' trust after contributions have been discontinued.	2(h).
69–159.....	1969–1, 133....	Deductions under union-negotiated plans..	2(h).
69–217.....	1969–1, 115....	Employees' voluntary contributions under qualified plans.	4(h).
69–230.....	1969–1, 116....	Deferral of 100 percent of compensation under plan intended to qualify as pension plan.	2(c).
69–231.....	1969–1, 118....	Written trust instrument executed before close of taxable year. See also Rev. Rul. 56–673, C.B. 1956–2, 281.	2(f); 3(a).
69–250.....	1969–1, 116....	Multi-employer plan and trust.....	2(e).
69–251.....	1969–1, 127....	Increase in benefits upon increase in compensation.	5(k).
69–252.....	1969–1, 128....	Notification by trustee of termination of plan.	2(h).
69–295.....	1969–1, 117....	Use of employees' vested interest under profit-sharing plan to make up deficiency in employer's contributions under pension plan.	2(q).
69–277.....	1969–1, 116....	Withdrawal of increments on employees' voluntary contributions at time contributions are withdrawn.	2(o)(1); 2(o)(5).

APPENDIX—Continued

Revenue Procedures cited in this compendium

Revenue Procedure number	Cumulative Bulletin reference	Content and subsequent action, if any	Part of this revenue ruling in which cited
56–22.....	1956–2, 1380...	Continued application of prior determination letter where profit-sharing plan is amended only to drop indefinite contribution formula.	2(h).
65–27.....	1965–2, 1017...	Guides for resolving issues connected with the tax classification of professional service organizations.	2(j)(2).
69–1.....	1969–1, 381....	Outline of general procedures for issuance of rulings and determination letters.	1(b).
69–4.....	1969–1, 391....	Outline of procedures for issuance of determination letters as to qualification of plans and status for exemption of trusts.	2(h); 2(k)(1).

26 CFR 1.401–1: Qualified pension, profit-sharing, and stock bonus plans

A pension plan under which the employer is not required to maintain the auxiliary fund at a particular level or to make contributions at any particular time fails to qualify under section 401(a) of the Code.

Rev. Rul. 69–427

Advice has been requested whether a pension plan will fail to qualify, under section 401(a) of the Internal Revenue Code of 1954, because it provides that disability benefits and early retirement benefits will be computed on the basis described below.

Retirement benefits under the plan are funded by typical level premium ordinary life insurance contracts plus employer contributions to an auxiliary fund in which separate accounts are maintained for each employee. The monthly benefit upon retirement at normal retirement age 65 is 50 percent of the retiring participant's career average monthly compensation. If the reserve under the contract on an employee's life plus his account balance in the auxiliary fund is not sufficient to purchase his benefits when he reaches age 65, the deficiency will be paid by the employer.

The plan also provides benefits in the event of early retirement or total and permanent disability. The benefit upon early retirement is that purchasable with the reserve under the insurance contract on the employee's life plus his vested interest in the auxiliary fund. The benefit upon disability retirement is that purchasable with the reserve under the contract plus the entire amount credited to the employee's account in the auxiliary fund. The plan states that, although the employer intends to make annual contributions at a level sufficient to satisfy the liabilities under the plan, he may temporarily suspend contributions to the auxiliary fund.

A pension plan within the meaning of section 401(a) of the Code is a plan established and maintained by an employer primarily to provide systematically for the payment of *definitely determinable* benefits to his employees over a period of years, usually for life, after retirement. See section 1.401–1(b)(1)(i) of the Income Tax Regulations.

The employer in this case is not required to maintain the auxiliary fund at a particular level or to make contributions at any particular time. Under these circumstances, benefits upon early retirement or retirement for disability are not definitely determinable as required by section 1.401–1(b)(1)(i) of the regulations.

Accordingly, it is held that the plan fails to qualify under section 401(a) of the Code.

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26 CFR 1.401–1: Qualified pension, profit-sharing, and stock bonus plans.

The qualification of a pension plan for common-law employees of a partnership is adversely affected by an amendment permitting the continued increase in the vested interest of only those former employees who become partners.

Rev. Rul. 69–477

Advice has been requested whether the qualification, under section 401 of the Internal Revenue Code of 1954, of a pension plan that covers only the common-law employees of a partnership was adversely affected by the amendment described below.

A partnership maintained a qualified pension plan for the benefit of its common-law employees. The plan provided for graduated vesting based on years of service. A participant who was separated from service or became a partner retained his vested rights in contributions made on his behalf up to the date of separation.

Several common-law employees became partners in the partnership. The plan was then amended to permit the continued increase of such partners' vested interests based on their service as partners. The amended plan did not permit other employees who severed their employment relationship with the partnership a similar increase in vesting.

Section 401(a)(4) of the Code provides that a trust forming part of an employees' pension plan shall not constitute a qualified trust if contributions or benefits under the plan discriminate in favor of employees who are officers, shareholders, supervisors, or highly compensated.

Section 1.401–1(b)(4) of the Income Tax Regulations provides that a plan may be for the exclusive benefit of employees or their beneficiaries, as required under section 401(a) of the Code, even though it covers former employees as well as present employees or even if only former employees are covered by the plan.

Except to the limited extent applicable to participation of self-employed individuals after December 31, 1962, partners are not employees and as partners, may not participate in a qualified plan for common-law employees. See Rev. Rul. 69–114, C.B. 1969–1, 115. A partnership employee who becomes a partner terminates his employment status to the same extent as an employee who completely severs his relationship with the partnership. However, he may participate in a plan, as a former employee to the same extent as all other former employees.

If a partner becomes an active participant in a plan that provides for contributions for self-employed persons, he must, by reason of the contingent nature of his compensation, be considered highly compensated. See section 1.401–11(d) of the regulations. For the same reason, a partner must be considered highly compensated in comparison to other former employees even though he is merely participating for purposes of increased vesting in an account acquired while he was a common-law employee. Thus, if a partner's vested interest continues to increase after he terminates his service as a common-law employee but the vested interest of other former employees does not similarly increase, prohibited discrimination will result.

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It is held, therefore, that the qualification of the pension plan for the common-law employees of the partnership is adversely affected by the amendment permitting the continued increase in the vested interest of only those former employees who become partners.

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26 CFR 1.401–1: Qualified pension, profit-sharing, and stock bonus plans.

A pension plan established by a labor union does not meet the qualification requirements of section 401(a) of the Code where several participants in the plan are not employees of the union.

Rev. Rul. 69–493

A labor union established a pension plan for the benefit of the employees of the union. The plan was not adopted by any other employer. Several of the participants in the plan were not employees of the union.

Held, the pension plan in this case does not meet the qualification requirements of section 401(a) of the Internal Revenue Code of 1954 since it covers persons who are not employees of the union. See section 1.401–1(a)(3)(ii) of the Income Tax Regulations which provides that for a trust to be qualified under section 401(a) of the Code it must be part of a pension, profit-sharing, or stock bonus plan established by an employer for the exclusive benefit of his employees or their beneficiaries.

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26 CFR 1.401–1: Qualified pension, profit-sharing, and stock bonus plans.

Requirements that must be complied with where funds of an exempt employees' trust are to be invested in the stock or securities of the employer corporation; PS No. 49 superseded.

Rev. Rul. 69–494 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in PS No. 49, dated June 16, 1945, relating to the requirements an exempt employees' trust must comply with in order to invest funds in the stock or securities of an employer corporation.

An exempt employees' trust maintained by a corporate employer invests trust funds in the stock and securities of the employer. These investments are permitted under the trust instrument and under local law.

Section 1.401–1(b)(5)(i) of the Income Tax Regulations states that no specific limitations are provided in section 401(a) of the Code with respect to investments that may be made by the trustees of a trust qualifying under section 401(a). Generally, the contributions may be used by the trustees to purchase any investments permitted by the trust agreement to the extent allowed by local law. However, such a trust will be subject to tax under section 511 of the Code with respect to any "unrelated business taxable income" (as defined in section 512) realized by it from its investments. Furthermore, the tax-exempt status of the trust will be forfeited if the investments made by the trustees constitute "prohibited transactions" within the meaning of section 503 of the Code. See also the regulations under those sections.

Section 1.401–1(b)(5)(ii) of the regulations provides that, where trust funds are invested in stock or securities of the employer or other person described in section 503 of the Code, full disclosure must be made of the reasons for such arrangement and the conditions under which such investments are made in order that a determination may be made whether the trust serves any purpose other than constituting part of a plan for the exclusive benefit of employees. The trustee shall report any of such investments on the return that it is required to file and shall with respect to any such investment furnish the information required by such return.

Section 1.6033–1(a)(3) of the regulations provides that every employees' trust described in section 401(a) of the Code and exempt from Federal income taxation under section 501(a) shall file an annual return on Form 990–P, including the information required by section 1.401–1 of the regulations.

The primary purpose of benefiting employees or their beneficiaries must be maintained with respect to investments of the trust funds as well as with respect to other activities of the trust. This requirement, however, does not prevent others from also deriving some benefit from a transaction with the trust. For example, a sale of securities at a profit benefits the seller, but if the purchase price is not in excess of the fair market value of the securities at the time of sale and the applicable investment requisites have been met, the investment is consistent with the exclusive-benefit-of-employees requirement. These requisites are: (1) the cost must not exceed fair market value at time of purchase; (2) a fair return commensurate with the prevailing rate must be provided; (3) sufficient liquidity must be maintained to permit distributions in accordance with the terms of the plan, and (4) the safeguards and diversity that a prudent investor would adhere to must be present. However, the requirement set forth in item (2) with respect to a fair return is not applicable to obligatory investments in employer securities in the case of a stock bonus plan. See Rev. Rul. 69–65, C.B. 1969–1, 114. Upon compliance with these requisites, if the trust instrument and local law permit investments in the stock or securities of the employer, such investments are not deemed to be inconsistent with the purposes of section 401(a) of the Code.

In view of the foregoing, it is concluded that the trustee in this case must notify the District Director of Internal Revenue of the investment of trust funds in the stock and securities of the employer so that a determination may be made whether the trust serves any purpose other than constituting a plan for the exclusive benefit of employees. This notification is to be made as part of the annual information return, Form

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

990–P, unless an advance determination letter is requested. If an advance determination letter is requested, the notification is to be made as part of the request. The notification is to include the information called for under the appropriate provisions of section 4 of Revenue Procedure 69–4, C.B. 1969–1, 391, and is to be certified by the accounting or other responsible officer.

The filing of the required information does not automatically render the trust part of a plan for the exclusive benefit of employees. It is merely a means of enabling the District Director to make a determination with respect thereto. Neither is such a determination, nor the absence of a disapproval of the contemplated investment, to be construed as an opinion as to whether or not the purchase of the employer's stock or securities constitutes a good investment. In such matters the trustee should be guided by the trust instrument, local law, and his own judgment as a reasonably prudent investor.

PS No. 49 is hereby superseded since the position stated therein is restated under current law in this Revenue Ruling.

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26 CFR 1.401–1: Qualified pension, profit-sharing, and stock bonus plans.
(Also Section 7805; 301.7805–1.)

Where there is a provision for offsetting benefits under a pension plan by amounts received under a profit-sharing plan operating concurrently and covering the same employees, neither plan will qualify under section 401(a) of the Code.

Rev. Rul. 69–502

Advice has been requested whether the two plans described below meet the requirements for qualification, as a profit-sharing plan and as a pension plan, under section 401(a) of the Internal Revenue Code of 1954.

A corporation established a plan, intended to qualify as a profit-sharing plan under section 401(a) of the Code, under which contributions are to be made out of profits for the benefit of all employees. The corporation also established for the same employees, a second plan, intended to qualify as a pension plan under section 401(a) of the Code, providing a monthly retirement benefit after age 65 equal to 50 percent of each employee's average annual compensation, offset by the actuarial value of any amounts to which the employee might be entitled under the first plan. The specific question is whether the provision for offsetting benefits under the second plan by amounts received under the first affects the qualification of the plans.

With respect to the first plan described above, section 1.401–1(b)(3) of the Income Tax Regulations provides that a qualified plan must benefit the employees in general even though it need not provide benefits for all of the employees. That section also provides that a profit-sharing plan is not for the exclusive benefit of the employees in general if the funds therein may be used to relieve the employer from contributing to a pension plan operating concurrently and covering the same employees.

Since the funds held in an employee's account under the first plan will be used to reduce the employee's benefits under the second plan, the employer will be relieved from contributing to the second plan to the extent of those funds. Thus, the first plan is not for the exclusive benefit of the employees in general within the meaning of section 1.401–1(b)(3) of the regulations. Accordingly, it is held that this plan does not meet the requirements for qualification under section 401(a) of the Code.

With respect to the second plan, section 1.401–1(b)(1) of the regulations provides that a pension plan, within the meaning of section 401(a) of the Code, is a plan established and maintained by the employer primarily to provide systematically for the payment of definitely determinable benefits to his employees over a period of years, usually for life, after retirement. The determination of the amount of retirement benefits and the contributions to provide such benefits are not dependent on profits.

The amount of benefits payable out of the funds held under the second plan is contingent upon the amount available under the first plan. This, in turn, depends upon the amount of the employer's profits and the employer's willingness to make contributions from those profits. Under these circumstances, the benefits an employee will receive under the second plan are not definitely determinable as required by section 1.401–1(b)(1) of the regulations. Therefore, it is also held that the second plan does not meet the requirements for qualification as a pension plan under section 401(a) of the Code.

Pursuant to the authority contained in section 7805(b) of the Code, plans with respect to which favorable determination letters have been issued will not be treated as nonqualified plans, solely by reason of the position stated in this Revenue Ruling, provided that the plans are appropriately amended to eliminate the offset feature before the end of the first taxable year beginning after October 6, 1969, the date of the publication of this Revenue Ruling. Furthermore, union-negotiated plans with respect to which favorable determination letters have been issued will not be considered nonqualified plans, solely by reason of the position stated in this Revenue Ruling, if the plans are appropriately amended to eliminate the offset feature by the later of (1) the end of the first taxable year beginning after October 6, 1969, or (2) six months after the expiration of the applicable collective bargaining agreement in effect on October 6, 1969. Except for union-negotiated plans, such amendments must be made effective for all purposes not later than the first day of the taxable year of the employer beginning after October 6, 1969. In the case of union-negotiated plans, the amendments must be made effective not later than the first day of the first taxable year beginning after the later of (1) October 6, 1969, or (2) the date of the expiration of the ap-

plicable collective bargaining agreement.

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26 CFR 1.401–1: Qualified pension, profit-sharing, and stock bonus plans.

A pension plan that permits a participant to invest a portion of his account in life insurance contracts on the life of anyone in whom he has an insurable interest will not qualify under section 401(a) of the Code.

Rev. Rul. 69–523

Advice has been requested whether a pension plan may qualify under section 401(a) of the Internal Revenue Code of 1954 if it permits a participant to invest a portion of his account in life insurance contracts on the life of anyone in whom the participant has an insurable interest.

A corporation established a pension plan containing a provision that permits any participant to invest a specified portion of the contributions on his behalf in life insurance contracts on the life of anyone in whom the participant has an insurable interest. The plan provides that, in such cases, in the event of the death of the insured, the proceeds of the contract will be allocated to the participant's account and paid to him when his other plan benefits become payable.

Section 401(a) of the Code provides for the qualification of pension plans established for the exclusive benefit of the employer's employees.

Section 1.401–1(b)(1)(i) of the Income Tax Regulations states that a pension plan within the meaning of section 401(a) of the Code is a plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to his employees over a period of years, usually for life, after retirement. A pension plan may provide for the payment of incidental death benefits through insurance or otherwise. However, a plan is not a pension plan if it provides for the payment of benefits not customarily included in a pension plan.

The provision for investments in life insurance contracts in this case is not one that provides incidental death benefits through means of insurance on the life of the employee, as contemplated by section 1.401–1(b)(1)(i) of the regulations, but rather one that provides insurance on the life of anyone in whom the participant may have an insurable interest, such as a debtor. If the debtor or other person dies, the employee will collect on the insurance contract. Hence, he will be provided a benefit in addition to his definitely determinable benefits.

Accordingly, it is held that the pension plan in this case does not qualify under section 401(a) of the Code.

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26 CFR 1.401–1: Qualified pension, profit-sharing, and stock bonus plans.

A bank, through its trust department or trust officer, may act as trustee of its qualified employees' trust if so permitted under its charter and by-laws and the applicable state law; PS No. 18 superseded.

Rev. Rul. 69–535 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in PS No. 18, dated August 24, 1944. The questions presented relate to whether a bank may act as trustee of its own qualified employees' trust, through its trust department, or whether its trust officer, individually, may act as trustee.

A bank established an employees' pension plan intended to qualify under section 401(a) of the Internal Revenue Code of 1954. The bank, through its trust department, and the trust officer of the bank were named as trustees of the plan. This was not in violation of the bank's charter or by-laws and was permissible under applicable state law.

Section 1.401–1(a)(3)(ii) of the Income Tax Regulations provides that for an employees' trust to be qualified it must be part of a pension, profit-sharing, or stock bonus plan established by an employer for the exclusive benefit of his employees.

Section 1.401–1(b)(5)(i) of the regulations states that no specific limitations are provided in section 401(a) of the Code with respect to investments that may be made by the trustees of a trust qualifying under section 401(a). Generally, the contributions may be used by the trustees to purchase any investments permitted by the trust agreement to the extent allowed by local law. However, the tax exempt status of the trust will be forfeited if the investments made by the trustees constitute "prohibited transactions" within the meaning of section 503 of the Code.

Section 1.401–1(b)(5)(ii) of the regulations provides that where trust funds are invested in stock or securities of, or loaned to, the employer or other person described in section 503(c) of the Code, full disclosure must be made of the reasons for such arrangement and the conditions under which such investments are made in order that a determination may be made whether the trust serves any purpose other than constituting part of a plan for the exclusive benefit of the employees.

The answers to the questions depend upon the law prevailing in the particular state in which the bank is located or the law under which it is created and upon the provisions in its charter and by-laws. Since the applicable law and the provisions in its charter and by-laws permit the bank in this case to designate itself as trustee of a trust established by itself, it is held that the bank may act as trustee of its employees' trust. Furthermore, since the applicable law and provisions permit the bank to designate its trust officer as trustee of such a trust, it is also held that the trust officer may act as trustee of the employees trust.

While there is no objection to the bank acting as trustee of its employees' trust through its trust department, or to its trust officer, individually acting as a trustee, transactions between the

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

bank as employer and the bank or its trust officer, as trustee, are subject to the provisions of section 1.401–1(b)(5)(i) and (ii) of the regulations.

PS No. 18 is hereby superseded since the position stated therein is restated under current law in this Revenue Ruling.

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26 CFR 1.401–1: Qualified pension, profit-sharing, and stock bonus plans.

A corporation's plan will not fail to qualify under section 401(a) of the Code if it permits participation of an attorney who does legal work for the corporation as an employee and who also practices law as a self-employed individual.

Rev. Rul. 69–569

Advice has been requested whether a corporation's plan fails to qualify under section 401(a) of the Internal Revenue Code of 1954 if it permits the participation of an attorney who does the corporation's legal work under the circumstances described below.

The plan provides that all employees shall be participants thereunder The attorney does legal work for the corporation. He is paid a stated salary by the corporation, is subject to the direction and control of the corporation in carrying out its work, and is an employee of the corporation for all purposes, including coverage for social security and income tax withholding purposes.

The attorney also engages in a separate private law practice and his activities in this respect are not in any way controlled or directed by the corporation.

Section 1.401–1(a)(3)(ii) of the Income Tax Regulations provides that for a trust to be qualified under section 401(a) of the Code it must be part of a pension, profit-sharing, or stock bonus plan established by an employer for the exclusive benefit of his employees or their beneficiaries. Hence, a plan will not qualify if it includes participants who are not the employees of the employer. See Rev. Rul. 69–493, page 88, this Bulletin.

Section 1.401–10(b)(3)(ii) of the regulations states that an individual may be treated as an employee within the meaning of section 401(c)(1) of one employer (that is as a self-employed person) even though such individual is also a common-law employee of another employer. For example, an attorney who is a common-law employee of a corporation and who, in the evenings, maintains an office in which he practices law as a self-employed individual is an employee within the meaning of section 401(c)(1) with respect to the law practice. This example would not be altered by the fact that the corporation maintained a qualified plan under which the attorney is benefited as a common-law employee.

Thus, section 1.401–10(b)(3)(ii) of the regulations recognizes that an attorney or other professional person may be a bona fide employee and, as such, eligible to participate in a qualified plan. The mere fact that a professional person has an independent income from the practice of his profession will not necessarily preclude him from participating in such a plan. He must, however, be an employee for all purposes, including coverage for social security or a similar public program, if applicable to other employees, and for income tax withholding purposes. If his actual employment for such purposes commences as of a certain date, he is not to be credited for services prior thereto, such as, for example, meeting the years-of-service requirements to be eligible to participate in the plan or to obtain benefits based on past services.

Since the attorney is an employee of the corporation in this case, it is held that the plan does not fail to qualify under section 401(a) of the Code merely because the attorney is a participant. However, the attorney's contribution's or benefits under the plan are to be based only on the amount that he receives as an employee of the corporation.

26 CFR 1.401–1: Qualified pension, profit-sharing, and stock bonus plans.

A profit sharing plan of an affiliated group of corporations will not qualify under section 401(a) of the Code if it requires amounts forfeited as a result of termination of employment to be reallocated to all the participants of the adopting corporations.

Rev. Rul. 69–570

Advice has been requested whether a profit-sharing plan adopted by an affiliated group of corporations may qualify under section 401(a) of the Internal Revenue Code of 1954, if it provides for allocating forfeitures under the method described below.

A corporation that has four subsidiaries established a profit-sharing plan and related trust intended to meet the requirements of section 401(a) of the Code. Each subsidiary adopted the plan. All regular employees of the corporations with at least one year of service are covered by the plan. The five corporations are an affiliated group within the purview of section 1504 of the Code and file a consolidated income tax return. The plan's contribution formula requires a contribution of 25 percent of the consolidated net profits, not to exceed ten percent of all the participants' basic compensation. The plan also provides for graduated vesting of participants' interests and requires that amounts forfeited as the result of a termination of employment before a participant is fully vested be reallocated to the remaining participants on the basis of their account balances, regardless of whether the participants benefiting therefrom are employed by the corporation that employed the terminated employees.

Section 401(a)(2) of the Code provides that a plan will not qualify unless under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to the employer's employees and their beneficiaries under the trust, for any part of the corpus or income to be used for, or diverted to, purposes other than for

the exclusive benefit of the employees or their beneficiaries.

An employees' trust may be qualified under section 401(a) of the Code and exempt under section 501(a) even though several corporations make contributions thereto. However, the provisions relating to qualification under section 401(a) of the Code, as well as the provisions relating to deductions under section 404(a), are applicable to each employer separately. See Rev. Rul. 69–250, C.B. 1969–1, 116. Since amounts contributed for, and allocated to, employees of one employer may (in the event of their forfeiture) be used for the benefit of the employees of another employer, the plan and trust in this case do not meet the requirement, with respect to *each* employer, that the corpus or income not be used for purposes other than for the exclusive benefit of his employees.

Accordingly, it is held that this profit-sharing plan does not qualify under section 401(a) of the Code.

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26 CFR 1.401–1: Qualified pension, profit-sharing, and stock bonus plans.

An employees' profit-sharing plan, established by a corporation subsequent to a qualified pension plan, will not qualify under section 401(a) of the Code if the aggregate voluntary employee contribution permitted under both plans is in excess of 10 percent of compensation.

Rev. Rul. 69–627

Advice has been requested whether, under the circumstances described below, a profit-sharing plan may provide for voluntary employee contributions.

A corporation established a pension plan that has been held to meet the requirements for qualification under section 401 of the Internal Revenue Code of 1954. The plan provides that a participant may make voluntary contributions thereunder not in excess of 10 percent of his total compensation. Neither employer contributions nor the benefits derived therefrom are geared to the voluntary employee contributions.

The corporation subsequently established a profit-sharing plan covering the same employees who participate in the pension plan. The profit-sharing plan also provides that any participant may make voluntary contributions not in excess of 10 percent of his total compensation. Employer contributions under this plan, as in the pension plan, are not geared to the voluntary employee contributions. Employee contributions under both plans must be used to provide additional benefits only for the individual contributing employee.

Section 401(a) of the Code relates to the qualification of a trust forming part of a pension plan of an employer for the exclusive benefit of his employees where contributions are made to the trust by such employer, the employees, or both.

Revenue Ruling 59–185, C.B. 1959–1, 86, states that the tax advantages provided under a qualified employees' plan were not intended by Congress to be extended to unlimited contributions by employees. However, where the purpose of such a feature in a plan is to encourage savings by participants, an employee may make contributions to such plans provided the contributions are kept within reasonable bounds. Revenue Ruling 59–185 provides that employee contributions are deemed to be reasonable where they are not in excess of 10 percent of compensation. The 10-percent limitation referred to in Revenue Ruling 59–185 is meaningful only if it applies to the aggregate of voluntary contributions made by an employee under all qualified plans of his employer.

In this case, if an employee who participates in both plans makes the maximum employee contribution permitted under those plans, he will contribute 20 percent of his compensation. A voluntary employee contribution equal to 20 percent of a participant's compensation is not deemed to be a reasonable contribution under the rationale set forth in Revenue Ruling 59–185.

Accordingly, it is held that, under the circumstances of this case, the profit-sharing plan may not provide for voluntary employee contributions if the plan is to qualify under section 401(a) of the Code.

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26 CFR 1.401-1: Qualified pension, profit-sharing, and stock bonus plans.

Issuance of opinion letters involving definition of "compensation" in master or prototype plans intended to integrate with Social Security benefits. See Rev. Proc. 69–20, page 303.

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26 CFR 1.401–1: Qualified pension, profit-sharing, and stock bonus plans.

Elimination of advance determinations as to qualification of plans that include self-employed individuals where employers adopt master or prototype plans previously approved as to form and discontinuance of use of Form 3673. See Rev. Proc. 69–24, page 306.

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26 CFR 1.401–1: Qualified pension, profit-sharing, and stock bonus plans.

Procedures for requests on the acceptability of form of master and prototype pension, profit-sharing and annuity plans designed to include self-employed individuals. See Rev. Proc. 69–30, page 312.

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26 CFR 1.401–3: Requirements as to coverage.

Situations explaining whether a subsidiary or division may, after July 5, 1968, commence participation in a company's existing integration plan or adopt a separate plan identical to the company's integration plan; Revenue Ruling 69–4 amplified.

Rev. Rul. 69–371

The Internal Revenue Service has been asked whether the transitional provisions contained in section 20 of Revenue Ruling 69–4, C.B. 1969–1, 118, regarding the integration of pension, annuity, profit-sharing, and stock bonus plans with old-age and survivors insurance benefits provided under the Social Security Act, are applicable in the situations described below.

Situation 1

Prior to July 6, 1968, Company *X* adopted and executed a pension plan that meets the applicable requirements of section 19.01 of Revenue Ruling 69–4. *X* subsequently acquired all of the stock of Company *Y*. *Y* was then liquidated and became a division of *X*. Effective August 1, 1968, all employees of the new division commenced participation in the pension plan of *X*, and in accordance with Revenue Ruling 62–139, C.B. 1962–2, 123, they qualified for and received credit, for pension purposes, for all service with *Y*.

In accordance with section 20.03 of Revenue Ruling 69–4, total service for these employees means all service with *X* plus the additional service with *Y* for which credit is given under the plan. Furthermore, since the pension plan of *X* was in effect and met the applicable requirements of section 19.01 of Revenue Ruling 69–4 on July 5, 1968, any date no later than December 31, 1971, may be specified as the date the plan will conform to the applicable provisions of section 20.01 or 20.02 of that Revenue Ruling.

Situation 2

Prior to July 6, 1968, Company *X* adopted and executed a pension plan that meets the applicable requirements of section 19.01 of Revenue Ruling 69–4. *X* subsequently acquired all of the stock of Company *Y*. *Y* was then liquidated and became a division of *X*. Effective August 1, 1968, a separate pension plan with employer-provided benefits identical to those of *X*'s plan was adopted for the division. The separate pension plan satisfied the requirements of Revenue Ruling 62–139 so that all employees of the new division qualified for and received credit, for pension purposes, for all service with *Y*.

Since the benefits for employees of the division are identical to those that would be provided if the division instead participated in the original pension plan of *X*, it is held that the provisions of section 19.01 of Revenue Ruling 69–4 are applicable in this situation, so that any date no later than December 31, 1971, may be specified as the date the division's plan will conform to the applicable provisions of section 20.01 or 20.02 of that Revenue Ruling.

On the other hand, if the employer-provided benefits for the employees of the division were not identical to those that are provided in the pension plan of *X*, the provisions of section 19.01 of Revenue Ruling 69–4 would not be applicable. The separate plan for the employees of the division would then be integrated only if it satisfied in all respects the applicable requirements of section 1.401–3(e)(2) of the Income Tax Regulations, as amended by T.D. 6982, C.B. 1968–2, 168, and of sections 3 though 18 of Revenue Ruling 69–4.

Situation 3

Prior to July 6, 1968, Company *X* adopted and executed a pension plan that meets the applicable requirements of section 19.01 of Revenue Ruling 69–4. *X* subsequently acquired all of the stock of Company *Y*. However, unlike *situations* 1 and 2, *Y* was not liquidated but continued as a subsidiary of *X*. Following the acquisition of *Y*, *X* amended its plan to define service as including all years of service with Company *X* and Company *Y* (both prior and subsequent to becoming a subsidiary of Company *X*), an acceptable definition under section 20.03 of Revenue Ruling 69–4. *Y* adopted the plan as amended. Effective August 1, 1968, all employees of *Y* commenced participation in the amended pension plan. In accordance with Revenue Ruling 62–139, these employees qualified for and received credit, for pension purposes, for all years of service with *Y* prior to its becoming a subsidiary of *X*.

In accordance with section 20.03 of Revenue Ruling 69–4, total service for these employees means all service with *X* and *Y*. Furthermore, since the pension plan of *X* was in effect and met the applicable requirements of section 19.01 of Revenue Ruling 69–4, any date no later than December 31, 1971, may be specified as the date the plan will conform to the applicable provisions of section 20.01 or 20.02 of that Revenue Ruling.

Situation 4

Prior to July 6, 1968, Company *X* adopted and executed a pension plan that meets the applicable requirements of section 19.01 of Revenue Ruling 69–4. *X* subsequently acquired all of the stock of Company *Y*, and *Y* continued as a subsidiary of *X*. Effective August 1, 1968, a pension plan with employer-provided benefits identical to those of *X*'s plan was adopted for the subsidiary. The plan for the subsidiary satisfied the requirements of Revenue Ruling 62–139 so that all employees of *Y* qualified for and received credit, for pension purposes, for all service with *Y* prior to its becoming a subsidiary of *X*.

Since the benefits for the employees of the subsidiary are identical to those that would be provided if the employees of the subsidiary instead participated in the pension plan of *X*, it is held that the provisions of section 19.01 of Revenue Ruling 69–4 are applicable in this situation, so that any date no later than December 31, 1971, may be specified as the date the subsidiary's plan will conform to the applicable provisions of section 20.01 or 20.02 of that Revenue Ruling.

On the other hand, if the employer-provided benefits for the employees of the subsidiary were not identical to those that are provided in the pension plan of *X*, the provisions of section 19.01 of Revenue Ruling 69–4 would not be applicable. The separate plan for the employees of the subsidiary would then be integrated only if it satisfied in all respects the applicable requirements of section 1.401–3(e)(2) of the regulations, as amended by T.D. 6982, and of sections 3 through 18 of Revenue Ruling 69–4.

The special minimum benefit provision of section 20.05 of Revenue Ruling 69–4 is applicable only to employees who on July 5, 1968, were entitled to benefits under the plan then in effect. Since the employees of *Y* in

situations 1 and *3* were not on July 5, 1968, entitled to any benefit under *X*'s plan, and since the newly adopted plans in *situations 2* and *4* were not in effect on July 5, 1968, it is further held that section 20.05 of Revenue Ruling 69–4 does not apply to the employees of *Y* in any of the four situations.

Revenue Ruling 69–4 is hereby amplified.

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26 CFR 1.401–3: Requirements as to coverage.

Revenue Ruling 69–4 is amplified to define "compensation" considered acceptable for purposes of determining whether pension, annuity, profit-sharing, and stock bonus plans that integrate with social security benefits will qualify under section 401(a) of the Code.

Rev. Rul. 69–503

Advice has been requested concerning the definition of compensation considered acceptable for purposes of sections 3.01, 5.02, 6.02, 6.03, 13.01, 13.02, and 14.02 of Revenue Ruling 69–4, C.B. 1969–1, 118, regarding the integration of pension, annuity, profit-sharing, and stock bonus plans with old-age and survivors insurance benefits provided under the Social Security Act.

It is always acceptable to define compensation for these purposes as the amount of compensation that would be subject to tax under section 3101 (a) of the Internal Revenue Code of 1954 without the dollar limitation of section 3121(a)(1) of the Code. However, whether the use of a different and more restrictive definition of compensation (such as basic compensation) results in prohibited discrimination in a plan intended to integrate with old-age and survivors insurance benefits depends on the facts of the individual case. In such a plan, where the ratio of restricted compensation to total remuneration is a higher proportion for highly compensated employees than it is for lower paid employees, discrimination in favor of highly compensated employees is likely to result. Therefore, in each case where a restrictive definition of compensation is used, it must be demonstrated that, after proper allowance for Social Security benefits, the prohibited discrimination cannot result.

It is held that, for purposes of sections 3.01, 5.02, 6.02, 6.03, 13.01, 13.02, and 14.02 of Revenue Ruling 69–4, compensation, if not defined in accordance with the first sentence of the preceding paragraph, may be defined as compensation inclusive or exclusive of bonuses, commissions, or overtime pay, or as basic compensation, or as regular rate of compensation, and the plan may qualify under section 401(a) of the Code, provided it is demonstrated that whatever definition is used cannot result in the discrimination prohibited by section 1.401–4(a)(1)(i) of the Income Tax Regulations.

Revenue Ruling 69–4 is hereby amplified.

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26 CFR 1.401–3: Requirements as to coverage.

Guides are presented for the integration of pension, annuity, profit-sharing or stock bonus plans that have two integration levels with benefits under the Social Security Act; Revenue Ruling 69–4 amplified.

Rev. Rul. 69–586

SECTION 1. PURPOSE

The purpose of this Revenue Ruling is to announce guides for determining whether a pension, annuity, profit-sharing, or stock bonus plan that has two integration levels is integrated with benefits provided by the Social Security Act as amended through 1967.

SEC. 2. BACKGROUND

Section 5.011 of Revenue Ruling 69–4, C.B. 1969–1, 118, provides that the integration level of a flat-benefit excess plan may be a stated dollar amount uniformly applicable to all active participants that does not exceed the covered compensation of any individual who is or may become a participant. Section 6.01 of Revenue Ruling 69–4 provides that the integration level of a unit-benefit excess plan may be the taxable wage base during the year or a lesser stated dollar amount. Sections 13 and 14.01 of Revenue Ruling 69–4 contain similar provisions for determining the integration level of a money-purchase, profit-sharing, or stock bonus plan.

SEC. 3. BASIC LIMITATION

An excess plan containing two integration levels is integrated if the benefit rate (or employer contribution rate) applicable at each integration level does not exceed the applicable limitation of Revenue Ruling 69–4 at such integration level, in a plan with only that one integration level.

Example 1. A flat-benefit excess plan that meets the requirements of section 4 of Revenue Ruling 69–4 provides normal annual retirement benefits upon retirement at age 65 with at least 15 years of service equal to 20% of average annual compensation in excess of $3,000 but not in excess of $4,800, plus 30% of average annual compensation in excess of $4,800. Such plan meets the requirements of this section because neither of the benefit rates exceeds 30% (*i.e.*, the limitation of section 5.02 of Revenue Ruling 69–4).

Example 2. A flat-benefit excess plan that meets the requirements of section 4 of Revenue Ruling 69–4 provides normal annual retirement benefits upon retirement at age 65 with at least 15 years of service equal to 20% of average annual compensation in excess of $3,000 but not in excess of $4,800, plus 37½% of average annual compensation in excess of $4,800. Such plan does not meet the requirements of this section because the benefit rate applicable to compensation in excess of $4,800 exceeds 30% (*i.e.*, the limitation of section 5.02 of Revenue Ruling 69–4). However, the plan should be further tested in accordance with section 4 of this Revenue Ruling.

SEC. 4. ALTERNATIVE LIMITATION FOR FLAT-BENEFIT EXCESS PLANS

A flat-benefit excess plan in which the lower integration level is less than

the covered compensation of any individual who is or may become a participant is integrated if:

.01 The rate at which the normal retirement benefit is provided with respect to the portion of average annual compensation in excess of the lower integration level but not in excess of the higher integration level does not exceed the ratio (adjusted in accordance with sections 8, 9, 10, and 12.03 of Revenue Ruling 69–4) of $500 to the plan's lower integration level, and

.02 The rate at which the normal retirement benefit is provided with respect to the portion of average annual compensation in excess of the higher integration level does not exceed the sum of:

1 The actual normal annual retirement benefit provided on the portion of average annual compensation in excess of the lower integration level but not in excess of the higher integration level (reduced by any benefit that, in accordance with section 12.03 of Revenue Ruling 69–4, is deemed attributable to employee contributions), *divided* by the higher integration level, plus

2 The applicable limitation determined in accordance with section 5.021 or 5.03 of Revenue Ruling 69–4 and adjusted in accordance with sections 8, 9, 10, and 12.03 of that Revenue Ruling; and

.03 The normal annual retirement benefit rates for an employee with less than 15 years of service with the employer at normal retirement age cannot exceed one-fifteenth of the benefit rates determined in accordance with sections 3.01 and 3.02, multiplied by his actual number of years of service.

Example. The facts are the same as Example 2 of section 3. The benefit rate applicable to the portion of average annual compensation in excess of $3,000 but not in excess of $4,800 exceeds 16⅔% (*i.e.*, $500 divided by $3,000), the limitation of section 3.01. Accordingly, such plan is not integrated, because the rates of benefit do not meet the requirements of either section 3 or section 4 of this Revenue Ruling.

SEC. 5. ALTERNATIVE LIMITATION FOR UNIT-BENEFIT EXCESS PLANS BASING BENEFITS ON ACTUAL COMPENSATION

A unit-benefit excess plan in which the lower integration level is less than that specified in section 6.01 of Revenue Ruling 69–4 is integrated if:

.01 The rate at which the normal retirement benefit is provided with respect to the portion of actual compensation in excess of the lower integration level but not in excess of the higher integration level does not exceed the ratio (adjusted in accordance with sections 8, 9, 10, and 12.01 of Revenue Ruling 69–4) of $16.67 to the plan's lower integration level, and

.02 The rate at which the normal retirement benefit is provided with respect to actual compensation in excess of the higher integration level does not exceed the sum of:

1. The actual normal annual retirement benefit provided on the portion of actual compensation in excess of the lower integration level but not in excess of the higher integration level (reduced by any benefit that, in accordance with section 12.01 of Revenue Ruling 69–4, is deemed attributable to employee contributions), *divided* by the higher integration level, plus

2. The applicable limitation determined in accordance with section 6.02 or 6.04 of Revenue Ruling 69–4 and adjusted in accordance with sections 8, 9, 10, and 12.01 of that Revenue Ruling.

Example. A unit-benefit excess plan that was established January 1, 1969, meets the requirements of section 4 of Revenue Ruling 69–4 and provides normal annual retirement benefits for service after the date of inception of the plan equal to ½% of actual compensation in excess of $3,600 but not in excess of $7,800, plus 1½% of actual compensation in excess of $7,800 during each year of service subsequent to such date. In case of death or severance of employment before retirement the participant or his survivor is entitled to a refund of the participant's contributions plus 4% interest. Each participant is required to make regular contributions of 1% of his actual compensation in excess of $3,600 but not in excess of $7,800 plus 3% of his actual compensation in excess of $7,800. Such plan is integrated; this is determined as follows:

1. Rate of benefit applicable to compensation between $3,600 and $7,800 does not exceed .588%:

	Percent
(a) $16.67 divided by $3,600	.463
(b) Increase for employee contributions from section 12.01 of Revenue Ruling 69–4: ⅛ x 1%	.125
(c) Total limitation: (a) plus (b)	.588

2. Rate of benefit applicable to compensation in excess of $7,800 does not exceed 1.577%:

(a) Actual normal retirement benefit of ½% x ($7,800–$3,600)	$21.00
(b) Normal retirement benefit deemed attributable to employee contributions of ⅛ x 1% x ($7,800–$3,600)	$5.25
(c) Excess of (a) over (b)	$15.75
(d) Higher integration level	$7,800
(e) Ratio: (c) divided by (d)	.202%
(f) Limitation from section 6.02 of Revenue Ruling 69–4	1.000%
(g) Increase for employee contributions from section 12.01 of Revenue Ruling 69–4: ⅛ x 3%	.375%
(h) Total limitation: (e) plus (f) plus (g)	1.577%

SEC. 6. ALTERNATIVE LIMITATION FOR UNIT-BENEFIT EXCESS PLANS BASING BENEFITS ON AVERAGE ANNUAL COMPENSATION

A unit-benefit excess plan in which the lower integration level is less than

that specified in section 6.01 of Revenue Ruling 69–4 is integrated if:

.01 The rate at which the normal retirement benefit is provided with respect to the portion of average annual compensation in excess of the lower integration level but not in excess of the higher integration level does not exceed the ratio (adjusted in accordance with sections 8, 9, 10, and 12.02 of Revenue Ruling 69–4) of $12.50 to the plan's lower integration level, and

.02 The rate at which the normal retirement benefit is provided with respect to average annual compensation in excess of the higher integration level does not exceed the sum of:

1. The actual normal annual retirement benefit provided on the portion of average annual compensation in excess of the lower integration level but not in excess of the higher integration level (reduced by any benefit that, in accordance with section 12.02 of Revenue Ruling 69–4, is deemed attributable to employee contributions), *divided* by the higher integration level, plus

2. The applicable limitation determined in accordance with section 6.03 or 6.04 of Revenue Ruling 69–4 and adjusted in accordance with sections 8, 9, 10, and 12.02 of that Revenue Ruling.

SEC. 7. ALTERNATIVE LIMITATION FOR MONEY-PURCHASE, PROFIT-SHARING, AND STOCK BONUS PLANS

A money-purchase, profit-sharing, or stock bonus excess plan in which the lower integration level is less than that specified in section 6.01 of Revenue Ruling 69–4 is integrated if:

.01 The rate of employer contributions with respect to the portion of actual compensation in excess of the lower integration level but not in excess of the higher integration level does not exceed $100 divided by the plan's lower integration level, and

.02 The rate of employer contributions with respect to actual compensation in excess of the higher integration level does not exceed the sum of:

1. The actual employer contribution with respect to the portion of actual compensation in excess of the lower integration level but not in excess of the higher integration level, *divided* by the higher integration level, plus

2. The applicable rate determined in accordance with section 13.01 or 14.02 of Revenue Ruling 69–4.

Example. A money-purchase excess plan that was established July 1, 1969, provides for employer contributions equal to 3% of actual compensation in excess of $3,000 but not in excess of $6,000, plus 7½% of actual compensation in excess of $6,000 for each year of service subsequent to such date. Such plan is integrated; this is determined as follows:

1. Rate of employer contribution applicable to compensation between $3,000 and $6,000 does not exceed 3⅓% (*i.e.*, $100 divided by $3,000).

2. Rate of employer contribution applicable to compensation in excess of $6,000 does not exceed 7½%:

(a) Actual employer contribution of 3% x ($6,000–$3,000) --	$90
(b) Higher integration level	$6,000
(c) Ratio: (a) divided by (b) ----------	1½%
(d) Applicable rate from section 13.01 of Revenue Ruling 69–4--	6%
(e) Total limitation: (c) plus (d)----------	7½%

SEC. 8. EFFECT ON OTHER DOCUMENTS

Revenue Ruling 69–4, C.B. 1969–1, 118, is hereby amplified.

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26 CFR 1.401–4: Discrimination as to contributions or benefits.

Qualification of a money purchase pension plan that does not include restrictions of section 1.401–4(c)(2) of the regulations respecting limitations on employer contributions that may be used for the benefit of the "25 highest-paid employees."

Rev. Rul. 69–415

Advice has been requested whether the money purchase pension plan described below fails to qualify under section 401 of the Internal Revenue Code of 1954 because it does not include the restrictions set forth in section 1.401–4(c)(2) of the Income Tax Regulations with respect to the employer contributions that may be used to provide benefits for the "25 highest-paid employees."

The plan provides that all employees who have been employed by the employer for at least two years are participants thereunder. The employer is to make annual contributions equal to five percent of the total compensation of each participant. Upon reaching the normal retirement age of 65 and actually retiring, a participant is entitled to such benefit as can be provided with the accumulated contributions and increments standing to his account.

Section 1.401–4(c)(1) of the regulations provides that the restrictions set forth in section 1.401–4(c)(2) need not be incorporated in a plan at the time it is established where the Commissioner of Internal Revenue determines that such provisions are not necessary to prevent the prohibited discrimination that may occur in the event of an early termination of the plan. Section 1.401–4(a)(2)(i) of the regulations provides that a plan will not be considered discriminatory merely because the contributions or benefits bear a uniform relationship to total compensation or to the basic or regular rate of compensation.

In this case all participants are treated alike with respect to employer contributions and the increments thereon. Contributions bear a uniform relationship to each employee's total compensation and no employee may obtain a disproportionate benefit because of his age or the method of funding. Under these circumstances, failure to incorporate in the plan the restrictions set forth in section 1.401–4(c)(2) of the regulations does not result in the prohibited discrimination.

Accordingly, it is held that the money purchase plan in this case does not fail to qualify merely because it does not contain the restrictions set forth in section 1.401–4(c)(2) of the regulations with respect to limitations on employer contributions that may be used for the benefit of the "25 highest-paid employees."

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26 CFR 1.401–11: General rules relating to plans covering self-employed individuals.

A partnership unit benefit pension plan that covers all the partners and does not provide separate accounts for the self-employed partner-participants does not qualify under section 401 of the Code.

Rev. Rul. 69–628

Advice has been requested whether, under the circumstances described below, a unit benefit pension plan of a partnership may qualify under section 401 of the Internal Revenue Code of 1954.

A partnership established a unit benefit pension plan covering all the partners, none of whom were owner-employees within the meaning of section 401(c)(3) of the Code. A qualified pension plan, providing comparable benefits for the partnership's common-law employees, had been established previously.

Each participating partner earns in excess of $25,000 per year. The plan provides that the partnership will contribute annually on behalf of each partner an amount equal to the lesser of $2,500 or 10 percent of his earned income.

Actuarial computations furnished by the partnership indicate that a $2,500 annual contribution for each partner will fund the required benefit at retirement only if benefits are paid out of the total aggregate amount of investments in a common fund, rather than by establishment of a separate account for each self-employed individual. Therefore, no separate accounts are provided for the partner-participants.

Section 1.401–11(b)(3) of the Income Tax Regulations states that the tax benefits allowed a self-employed individual are restricted by the limits placed on the deductions allowed for contributions on behalf of such an individual. That section of the regulations also provides that a self-employed individual participating in a qualified plan may not participate in any forfeitures, and that, in a qualified plan covering self-employed individuals, a separate account must be established for each self-employed individual to which no forfeitures can be allocated.

The purpose of the restrictions mentioned in section 1.401–11(b)(3) of the regulations is to limit the amount of the tax benefits allowed to a self-employed individual. If forfeitures could be allocated to the account of a self-employed individual, that individual's benefits could be increased by the allocation of forfeitures for which a deduction had been allowed, albeit for some other individual. Likewise, failure to establish separate accounts for each self-employed individual would permit an individual's benefit to be increased by amounts that were deducted because they were initially made on behalf of some other individual covered by the plan. In either case, the limitations on deductions allowed for contributions, and on the resultant tax benefits, in behalf of the self-employed individual could be circumvented. It is for this reason that section 1.401–11(b)(3) of the regulations requires (1) that a separate account be established for each self-employed individual, and (2) that no forfeitures be allocated to that account.

Since the plan in this case does not comply with the requirement that a separate account be established for each self-employed individual, it is held that it does not qualify.

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26 CFR 1.401–12: Requirements for qualification of trusts and plans benefiting owner-employees.

A premature distribution to an owner-employee does not adversely affect the qualified status of a trusteed pension plan with respect to all other participants.

Rev. Rul. 69–380

Advice has been requested whether, under the circumstances described below, a premature distribution to an owner-employee adversely affects the qualified status of a pension plan.

A sole proprietor established a trusteed pension plan for the benefit of himself and all his employees. The plan was held to qualify under section 401 of the Internal Revenue Code of 1954.

After the plan had been in operation for several years, the sole proprietor decided that he no longer wanted to participate. Although he had neither attained age 59½ nor become disabled, he requested and received a distribution of his interest in the plan from the trustee. He continued making contributions for the benefit of his other employees, but made no further contribution for his own benefit.

Section 401(d)(4)(B) of the Code provides that a plan must not permit benefits to be paid to an owner-employee prior to his attaining age 59½ or becoming disabled. Section 401(d)(5)(C) of the Code and section 1.401–12(m)(1)(ii) of the Income Tax Regulations provide that if, despite the restrictions in the plan that are required by section 401(d)(4)(B), an amount is prematurely distributed to an owner-employee, then no contribution may be made under the plan by, or for, such person for five taxable years succeeding the taxable year of the distribution. In addition, section 72(m)(5) of the Code provides specific tax penalties that apply to the distributee of a premature distribution.

Thus, the specific penalties provided in the Code for premature distributions are applied only against the owner-employee-distributees. There is no provision under which a premature distribution affects the qualification of the plan itself.

Accordingly, under the facts in this case, it is held that the premature distribution to the owner-employee

does not affect the qualification of the plan, which, if all other requirements are met, remains in effect with respect to all other participants.

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26 CFR 1.401–12: Requirements for qualification of trusts or plans benefiting owner-employees.

An employees' retirement plan that grants the owner-employee credit for his past service as a partner in a former partnership but does not grant common-law employees credit for their past service with former employers does not qualify under section 401 of the Code.

Rev. Rul. 69–409

Advice has been requested whether, under the circumstances described below, a plan of a physician in private practice may qualify under section 401 of the Internal Revenue Code of 1954 where it grants credit for past service with a partnership of which he was a partner.

The physician had been a member of a partnership for more than three years. The partnership was dissolved and the physician continued the practice of medicine as an individual practitioner. None of his employees had been a common-law employee of the partnership.

The physician established an employees' retirement plan intended to meet the requirements of section 401 of the Code. The plan provides that each common-law employee or employee within the meaning of section 401(c)(1) of the Code, including the owner-employee physician, will be eligible to participate in the plan after three years of service with either the physician or the partnership of which he was previously a member.

Section 1.401–10(b)(4) of the Income Tax Regulations provides that for the purpose of determining whether an employee, within the meaning of section 401(c)(1) of the Code, satisfies the requirements for eligibility under a qualified plan established by an employer, such an employer may take into account past services rendered by such an employee both as a self-employed individual and as a common-law employee if past services by other employees, including common-law employees, are similarly taken into account. However, an employer cannot take into account only past services rendered by employees within the meaning of section 401(c)(1) of the Code if past services rendered to such employer by individuals who are, or were, common-law employees are not taken into account.

Section 1.401–12(e)(2)(iii) of the regulations provides that under a qualified plan including owner-employees, past service of any employee may be taken into account as provided in section 1.401–10(b) of the regulations, in determining whether such employee, including any owner-employee, has three years of service. If an employer takes into account past service for any owner-employee, he must take into account the past service of his other employees to the same extent. Thus, where a sole proprietor is to be given credit for his past service with a former partnership then all employees must similarly be given credit for their past service with employers for whom they formerly worked.

In this case the plan grants the physician credit for his past service as a partner in the former partnership but does not similarly grant common-law employees credit for past service with former employers. Accordingly, it is held that the plan does not qualify under section 401 of the Code.

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26 CFR 1.401–12: Requirements for qualification of trusts and plans benefiting owner-employees.

The qualification of a profit-sharing plan of an owner-employee is adversely affected by an amendment permitting employer contributions for common-law employees, in amounts greater than required, to be redesignated as "excess contributions" and returned to the employer.

Rev. Rul. 69–524

Advice has been requested whether the qualification of a profit-sharing plan under section 401 of the Internal Revenue Code of 1954 is adversely affected by the amendment described below.

A sole proprietor maintained a qualified profit-sharing plan covering himself and his common-law employees. The contribution formula under the plan provides for employer contributions of up to ten percent of earned income, limited to $2,500 for the sole proprietor, and of up to ten percent of compensation for common-law employees. The aggregate annual employer contribution is further limited to ten percent of the net profits of the business. The plan also provides that the employees' rights in the employer contributions are nonforfeitable when made.

The employer, a cash basis taxpayer, makes contributions for each taxable year before the close of that taxable year. Since the net profits for a particular year are not known until the end of that year, each year's contributions are based on estimates of the net profits for the year. This practice has often resulted in contributions being less than that allowable under the contributions formula when actual compensation and net profit figures were used.

In order to provide for the maximum amount of contribution, the plan was amended to postpone allocation of contributions from the year of contribution to the succeeding taxable year. The employer increased his estimates of employee compensation and net profits when computing contributions for each year. The amounts so determined were paid into the trust before the close of the taxable year but were not allocated to individual employee accounts until the succeeding taxable year. As a result, amounts in excess of the permissible contribution remained in the trust after allocations were made. Pursuant to the amendment, these amounts were then allo-

cated to the owner-employee, treated as contribution made on behalf of the owner-employee, and returned to the employer as an "excess contribution." See section 401(e) of the Code.

Section 401(a)(2) of the Code provides that a trust forming part of a stock bonus, pension, or profit-sharing plan shall not constitute a qualified trust unless it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be used for, or diverted to, purposes other than for the exclusive benefit of the employees or their beneficiaries.

Section 401(d)(2) of the Code provides that a trust forming part of a qualified profit-sharing plan that benefits an owner-employee shall constitute a qualified trust only if, in addition to meeting the other requirements of section 401, the employee's rights to or derived from the contributions under the plan are nonforfeitable at the time the contributions are paid to or under the plan.

Although the general provisions of section 401(a)(2) and 401(d)(2) are applicable to owner-employees as well as to common-law employees, specific treatment is provided under the Code and Income Tax Regulations for excess employer contributions made *on behalf of owner-employees*. Section 401(e) of the Code defines such excess contributions and requires that they be repaid to the owner-employee. Section 1.401–13(d)(2)(iii) of the regulations provides that an excess employer contribution is treated as repaid to the owner-employee if an adequate adjustment is made to the account of the owner-employee. However, no such treatment is accorded to any employer contributions made on behalf of common-law employees. Consequently, employer contributions made *on behalf of common-law employees* cannot be later characterized as excess contributions for owner-employees in order to secure the return of these amounts without violating the requirement that employer contributions for common-law employees must be nonforfeitable at the time of payment and may not be diverted for purposes other than for the exclusive benefit of the employees.

Since, under the facts presented, the funds may be diverted, it is held that the plan, as amended, no longer qualifies under section 401(a) of the Code.

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26 CFR 1.401–13: Excess contributions on behalf of owner-employees.

A voluntary contribution by a partner to purchase term life insurance not to exceed $1,000 for each $10 of his monthly retirement income under a partnership's qualified pension plan is not an "excess contribution" as defined in section 401(e) of the Code.

Rev. Rul. 69–399

Advice has been requested whether, under the circumstances described below, a voluntary contribution by a partner, under a qualified pension plan, is an "excess contribution" as defined in section 401(e) of the Internal Revenue Code of 1954.

A partnership maintains an employees' pension plan that meets the requirements for qualification under section 401 of the Code. The plan, which provides benefits for all employees including owner-employees as defined in section 401(c)(3) of the Code, is funded through the purchase of retirement annuity contracts. The employer contribution is computed in accordance with the "three-year averaging" provisions of section 401(e)(3) of the Code applicable to annuity plans funded on a level premium basis. The plan contains a provision permitting each participant to make voluntary contributions to purchase a term insurance policy on his life in an amount not to exceed $1,000 for each $10 of monthly retirement income.

Section 401(e) of the Code provides that, except with regard to employer contributions under plans using the three-year averaging provisions of section 401(e)(3), the amount of any contribution allocable to the purchase of life insurance shall not be taken into account when considering whether an excess contribution has been made on behalf of an owner-employee.

Section 1.401–13(c) of the Income Tax Regulations describes the application of the three-year averaging provisions in computing employer contributions on behalf of an owner-employee where such contributions are applied to pay premiums on annuity, endowment, or life insurance contracts. It provides that the term "excess contribution" does not include any amount so applied if total employer contributions, including amounts allocable to the purchase of life, accident, health, or other insurance, do not exceed $2,500.

Section 1.401–13(c) of the regulations is applicable to employer contributions only. Accordingly, although the plan in this case uses the three-year averaging provisions in computing employer contributions, employee contributions on behalf of the owner-employee need not be limited to $2,500 where such contributions are allocable to the purchase of life insurance.

Based on the foregoing, it is held that, in this case, the voluntary employee contribution allocable to the purchase of life insurance in an amount not to exceed $1,000 for each $10 of monthly retirement income is not an excess contribution as defined in section 401(e) of the Code.

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26 CFR 1.401–13: Excess contributions on behalf of owner-employees.

The entire amount of an excess contribution not willfully made on behalf of an owner-employee under a qualified pension plan must be returned to him even if there has been a decline in value of the no-load mutual fund shares purchased with the excess contribution.

Rev. Rul. 69–571

Advice has been requested as to the amount to be repaid to an owner-employee as an "excess contribution"

under the circumstances described below.

A partnership established a pension plan that meets the requirements for qualification under section 401 of the Internal Revenue Code of 1954. The plan provides that administrative expenses of the fund are to be paid by the employer.

At the end of the first plan year, a contribution of $2,500 was made on behalf of an owner-employee. The entire contribution was invested in shares of a no-load mutual fund. During the second plan year, it was discovered that $500 of the amount contributed in the previous year was an excess contribution within the meaning of section 401(e) of the Code. At the time the excess contribution was discovered, the fair market value of the shares had declined to $2,000.

Section 1.401–13(d)(3)(i) of the Income Tax Regulations provides that, in the case of an excess contribution not willfully made, if the net amount of such excess contribution and the net income attributable to such amount are not repaid as prescribed therein, the plan will be disqualified with respect to the owner-employee.

Section 1.401–13(d)(4) of the regulations defines the "net amount of an excess contribution" as the amount of such excess contribution, reduced by the amount of any loading charge or other administrative charge ratably allocable to such excess contribution.

A loss in the market value of securities purchased with an excess contribution is not a loading charge or other administrative charge within the meaning of section 1.401–13(d)(4) of the regulations. Accordingly, it is held that the entire $500 is to be returned to the owner-employee as an excess contribution.

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).

Distributions from profit-sharing trusts within one taxable year on account of an employee's death or other separation from service are treated as long term capital gains even though some distributions have been made in prior years; PS No. 59 and I.T. 3847 superseded.

Rev. Rul. 69–495 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in PS No. 59, dated February 25, 1947, and I.T. 3847, C.B. 1947–1, 65, relating to the applicability of long-term capital gain treatment to distributions from a qualified profit-sharing trust on account of an employee's death or other separation from service where some distributions have been made in prior years.

An employer maintains a qualified profit-sharing plan in which employees are not entitled to any distributions for a specified period of years. Upon the expiration of the specified period, annual distributions are made until the employee retires or is otherwise separated from service. At the time of such retirement or separation from service, the balance to which he is entitled under the plan becomes immediately payable to him.

Section 402(a)(2) of the Internal Revenue Code of 1954 provides that, if total distributions payable to an employee are paid to the distributee within one taxable year of the distributee on account of the employee's death or other separation from service, or on account of death after separation from service, the amount of such distribution shall be considered a gain from the sale or exchange of a capital asset held for more than six months.

The term "total distributions payable," as used in section 402(a)(2) of the Code, means the balance to the credit of an employee which becomes payable to a distributee on account of the employee's death or other separation from service, or on account of his death after separation from service. See section 402(a)(3)(C) of the Code. Thus, distributions made before a total distribution (for example, annuity payments received by the employee after retirement) will not defeat application of the capital gains treatment with respect to the total distributions received by a beneficiary upon the death of the employee after retirement. See section 1.402(a)1(a)(6)(ii) of the Income Tax Regulations.

Accordingly, it is held in this case that the long-term capital gains treatment provided for in section 402(a)(2) of the Code is applicable to distributions on account of an employee's death or other separation from service, or on account of death after separation from service, if the balance to such employee's credit at that time is paid in one taxable year of the distributee, even though some distributions may have been made to the employee in prior years in accordance with the provisions of the plan.

PS No. 59 and I.T. 3847 are hereby superseded since the position stated therein is restated under current law in this Revenue Ruling.

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

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26 CFR 1.402(a)–1: Taxability of beneficiary under a trust which meets the requirements of section 401(a).
(Also Sections 3121, 3306, 3401; 31.3121(d)–1, 31.3306(i)–1, 31.3401(c)–1.)

A lump-sum distribution from a qualified pension trust to a retiree who has agreed to render part-time consulting services for his employer subsequent to retirement qualifies for long-term capital gains; amounts paid for such services are not wages for purposes of employment taxes.

Rev. Rul. 69–647

Advice has been requested whether a lump-sum distribution from an employees' pension trust (which has been held to meet the requirements of section 401(a) of the Internal Revenue Code of 1954 and to be exempt under section 501(a) of the Code) may be treated as having been made on account of "separation from the service" so as to be entitled to the long-term

capital gains treatment provided by section 402(a)(2) of the Code, where the taxpayer will render consulting services subsequent to his retirement.

The taxpayer and his employer executed a contract under which the taxpayer, upon his retirement, will remain available in a consulting and advisory capacity on a part-time basis for a period of five years.

In addition to rendering such services, the taxpayer agreed that during the term of the contract he will not engage in any business, either directly or through substantial ownership, that may be competitive with that of his employer.

The contract does not provide any formal schedule of duties or assignments for the taxpayer. He is expected to render only advisory services on an irregular basis on matters with respect to which he has special competence by reason of his former employment with the company.

In consideration for these services, the employer agreed to compensate the taxpayer after retirement at 30 percent of his salary, which was in effect immediately preceding his retirement, but not less than 20*y* dollars per year. Under this formula, the taxpayer was entitled to 30*y* dollars per year.

It is further provided that the employer will not exercise supervision over the taxpayer in the performance of his advisory services, nor will it require his compliance with detailed orders or instructions. There will be no established work schedule nor will it be necessary for the taxpayer to obtain the employer's permission to be absent from work.

Prior to retirement the taxpayer performed full-time services as a senior executive with the company. After retirement he will be expected to act solely in a part-time advisory capacity and he will cease to be an executive and administrative officer of the company. His salary will stop at retirement and he will be regarded by the company as a retired employee for purposes of the company's qualified contributory retirement plan.

Where an employer does not exercise or retain the right to exercise the direction and control necessary under the common law rules to establish the relationship of employer and employee, such relationship does not exist for Federal employment tax purposes. See section 31.3306(i)-1(b) of the Employment Tax Regulations.

Therefore, the amounts that will be paid under the contract described herein are not "wages" for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, or the Collection of Income Tax at Source on Wages.

Section 402(a)(2) of the Code provides, in part, that in the case of an employees' trust described in section 401(a), exempt from tax under section 501(a), if the total distributions payable with respect to any employee are paid to the distributee within one taxable year of the distributee on account of the employee's death or other separation from the service, the amount of such distributions, to the extent exceeding the amount contributed by the employee, if any, shall be treated as a long-term capital gain.

Accordingly, under these circumstances, the employee has separated from the service of his employer and total distributions of everything to his credit at the time of such separation from service and paid within one taxable year will qualify for the long-term capital gains treatment provided under section 402(a)(2) of the Code.

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26 CFR 1.402(a)-1: Taxability of beneficiary under a trust which meets the requirements of section 401(a).

Unearned premium credit reallocated to the trust to pay life insurance premiums for the remaining employees upon termination of participant's employment. See Rev. Rul. 69-490, page 11.

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26 CFR 1.402(a)-1: Taxability of beneficiary under a trust which meets the requirements of section 401(a).

Cost of current life insurance protection provided under a qualified plan that contains forfeiture provisions. See Rev. Rul. 69-544, page 12.

Section 403.—Taxation of Employee Annuities

26 CFR 1.403(b)-1: Taxability of beneficiary under annuity purchased by a section 501(c)(3) organization or public school.

A teacher in a county school system that contributes to an annuity plan may not include prior service with a noncontributing county in computing the exclusion allowance; further, the allowance is decreased by state contributions to a separate county retirement plan.

Rev. Rul. 69-629

Advice has been requested whether, under the circumstances described below, a teacher in a county school system may include prior service with another school system in computing the exclusion allowance under an arrangement that meets the requirements of section 403(b) of the Internal Revenue Code of 1954. Advice has also been requested whether the exclusion allowance must be reduced because of contributions by the state to a separate program, qualified under section 401(a) of the Code, for the benefit of the teacher.

A public school teacher was employed by the school system of County *A* for a period of two years. During this time, the county made no contributions towards the purchase of an annuity contract for any of its employees. Subsequently, the teacher was employed in the same state by County *B*'s school system. County *B* does make contributions towards the purchase of nonforfeitable annuities under an arrangement referred to in section 403(b) of the Code.

In addition to the above annuity purchase arrangement, a retirement program, qualified under section 401(a) of the Code, is maintained by County *B* for the benefit of its teachers. The state makes contributions to this program on behalf of the county teachers although, under state law, County *B*, and not the state, is their employer.

Section 403(b) of the Code provides that if an annuity contract is purchased for an employee who performs services

for a section 501(c)(3) organization or public school and the annuity contract is not one purchased pursuant to a plan qualified under section 401(a), then amounts contributed by the employer for the contract on or after the date the rights become nonforfeitable shall be excluded from the employee's gross income for the taxable year to the extent that the aggregate of these amounts does not exceed the applicable exclusion allowance for the taxable year.

In computing an employee's exclusion allowance for a taxable year, it is necessary to determine the employee's number of years of service for the employer as of the close of such taxable year. Section 1.403(b)-1(f)(1) of the Income Tax Regulations. Furthermore, the exclusion allowance must be reduced by amounts contributed, on behalf of the employee, to a trust meeting the requirements of section 401(a) of the Code. See section 1.403(b)-1(d)(3)(i) of the regulations.

The years of service referred to in section 1.403(b)-1(f)(1) of the regulations are *years of service with the employer that purchases the annuity for the employee.* Thus in this case, where County *B* is the present employer of the teacher and is making contributions on his behalf towards the purchase of an annuity within the meaning of section 403(b) of the Code, only years of service with County *B* may be considered in computing the exclusion allowance. Accordingly, service with County *A* may not be used in determining the teacher's exclusion allowance.

Where someone other than the employer makes contributions to a plan qualified under section 401(a) of the Code, or to a nonqualified plan under section 403(b), as far as participants are concerned, when they receive benefits they are being compensated for services rendered. This is the theory on which they are taxed both with respect to the contributions made on their behalf and the increments thereon. In this case, the State's contributions to the qualified program on behalf of County *B*'s teachers represent compensation for services rendered and thus, are amounts contemplated by section 1.403(b)-1(d)(3)(i) of the regulations. Accordingly, the teacher's exclusion allowance must be reduced by the amount of such contributions made on his behalf by the State to the qualified retirement program maintained by County *B*.

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.

Payments made to a trust, on behalf of retired employees, under an accident and health plan. See Rev. Rul. 69-478, page 29.

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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.

Whether payments made under an annual incentive bonus plan are deductible under section 404(a)(5) of the Code. See Rev. Rul. 69-649, page 106.

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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.

Whether payments made under a deferred plan are deductible under section 404(a)(5) of the Code. See Rev. Rul. 69-650, page 106.

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26 CFR 1.404(a)-3: Contributions of an employer to or under an employees' pension trust or annuity plan that meets the requirements of section 401(a); application of section 404(a)(1).

Examples illustrate the methods of allocating costs among employers for the purpose of determining deductions under sections 404(a)(1) or 404(a)(2) of the Code where two or more employers maintain a joint pension or annuity plan for their employees; PS No. 51—Part A superseded.

Rev. Rul. 69-525 [1]

The purpose of this Revenue Ruli is to update and restate, under the cu rent statute and regulations, the pos tion set forth in PS No. 51—Part A dated July 31, 1945. This ruling relat to the methods of allocating cos among employers for the purpose c determining deductions under sectio 404(a)(1) or 404(a)(2) of the Inte nal Revenue Code of 1954, where tw or more employers maintain a joi pension or annuity plan for thei employees.

An employees' plan may be qualifie under section 401(a) of the Code eve though several corporations mak contributions thereto. However, th provisions relating to qualificatio under section 401(a) of the Code a well as the provisions relating to deduc tions under section 404(a) are applica ble to each employer separately. Se Rev. Rul. 69-250, C.B. 1969-1, 11 Therefore, deductions from the gro income of each employer must be base on its separate costs determined b separate computations if such a metho is feasible. Where separate computa tions of costs are not feasible, som other method of distributing costs, suc as allocation in proportion to partici pating payrolls, may be acceptable i it is reasonable and is consistentl followed.

The acceptability of any method c allocation will depend upon its bein consistently followed, unless there ar sufficient reasons for change. When method of allocation is changed, th reasons for the change must be full explained in an attachment to For 2950, Statement in Support of Dedu tion for Payment to an Employee Pension, Profit-Sharing, Stock Bon Trust or Annuity Plan and Compens tion Under a Deferred-Payment Pla in order that the District Director Internal Revenue may determi whether the new method of allocatio is proper. See section 1.404(a)-2(b (1) of the Income Tax Regulatio

[1] Prepared pursuant to Rev. Proc. 67- C.B. 1967-1, 576.

No method that results in manipulation will be acceptable.

The application of the foregoing principles does not depend upon whether the employers are entitled to file consolidated returns or, if they are so entitled, whether they actually file separate or consolidated returns. These principles are illustrated by the facts and results obtained in the situations described below.

Situation 1. Two corporations established a joint employees' pension plan that qualified under section 401(a) of the Code. Each corporation is able to determine the separate cost of the plan properly attributable to it.

Under the foregoing facts, it is held that each corporation's deductions under section 404(a)(1) of the Code must be based on the separate costs determined for it.

Situation 2. As of January 1, 1968, corporation *X* and corporation *Y* established a joint employees' pension plan for the benefit of their employees. The terms of the plan apply equally to the employees of both corporations, and there are no special circumstances that could reasonably result in exceptionally wide differences in distributions to employees by length of service, age, etc. Since employees are continually shifted between the two corporations, it is not feasible to determine by separate computations the costs properly attributable to each corporation. The annual compensation for 1968 of participating employees of *X* was $1,600,000, and for *Y* $800,000. The lump-sum cost of past service benefits for all employees under the plan was computed as $1,500,000, and the normal cost for the year 1968 was computed as $120,000. The corporations allocated initial past service costs as $1,000,000 for *X* and $500,000 for *Y*. The corporations allocated the normal cost for the year 1968 as $80,000 for *X* and $40,000 for *Y*.

It is held in this situation that the allocation of costs for the first year is acceptable. So long as each corporation continues to pay its share of the costs allocated by this method, this method of allocation will also be acceptable for the subsequent years. However, if either corporation pays its share of the costs, while the other fails to pay its share and thereby allows its unfunded past service costs to increase, continued allocation of the aggregate unfunded past service costs in proportion to participating payrolls would no longer be proper, since the corporation paying its share of the costs would eventually be paying the costs of the other corporation as well. It would then become necessary for each corporation to carry forward its past service base separately.

Situation 3. Several corporations established a joint pension plan that qualified under section 401(a) of the Code. Separate computations of costs are not feasible and allocation of costs in proportion to participating payrolls is not reasonable under all the circumstances.

In this situation, it is held that any reasonable method of allocating costs will be acceptable if consistently followed.

For treatment of deductions for contributions under a profit-sharing plan maintained by affiliated companies, see section 404(a)(3)(B) of the Code and section 1.404(a)-10 of the Income Tax Regulations.

PS No. 51—Part A is hereby superseded, since the positions stated therein are restated under current law in this Revenue Ruling.

Section 405.—Qualified Bond Purchase Plans

26 CFR 1.405-1: Qualified bond purchase plans.

Use of Form 4578, by self-employed individuals who adopt a bond purchase plan, to request advance determinations. See Rev. Proc. 69-24, page 306.

Part II. Certain Stock Options

Section 422.—Qualified Stock Options

26 CFR 1.422-2: Qualified stock options defined.

The simultaneous granting of qualified and nonstatutory stock options under the same corporate stock option plan does not of itself disqualify such plan under section 422(b) of the Code or affect qualified stock options granted thereunder.

Rev. Rul. 69-428

A corporation has a stock option plan under which it simultaneously grants qualified stock options within the meaning of section 422(b) of the Internal Revenue Code of 1954 and nonstatutory stock options to the same optionees. Both options are granted at the same option price, and are for the same number of shares. The qualified stock options have a five-year life. The nonstatutory stock options have a ten-year life but may not be exercised until five years and one day after the date they are granted. The number of shares that may be purchased upon the exercise of the nonstatutory option is reduced by the number of shares that the optionee acquired upon the exercise of the qualified option.

Held, the simultaneous granting of the qualified stock option and a nonstatutory stock option under the same plan do not solely for that reason disqualify the corporation's stock option plan under section 422(b) of the Code and does not affect options granted under that plan as qualified stock options.

Section 425.—Definitions and Special Rules

26 CFR 1.425-1: Definitions and special rules applicable to statutory options.

An amendment to the terms of an employees' stock option plan to provide the optionee an alternative method to designate a person who may exercise his option in the event of death is not a modification under section 425(h)(3) of the Code.

Rev. Rul. 69-648

A corporation has a qualified stock option plan that meets the requirements of section 422 of the Internal Revenue Code of 1954. As required by section 422(b)(6) of the Code,

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the terms of an option granted under the plan provide that during the lifetime of an optionee the option is exercisable only by him.

The terms of the options also provide that the options are transferable only upon the death of an optionee, at which time the options are then exercisable by, or in accordance with the directions of, the executor or administrator of the optionee's estate. In this regard, the terms of the options provide that an optionee may designate the person who may exercise his option in the event of his death only by appointing that person in his will.

The corporation has now amended the foregoing option terms to provide a means by which an optionee would be permitted to designate other than by will the person who may exercise his option after death. The terms of the options as amended provide that such a designation can now be made by an optionee either by will, or by giving appropriate notice to the corporation as to the name of the person who may exercise the option after the optionee's death.

Held, the amendment to the option terms in the instant case is not a "modification" of the option within the meaning of section 425(h)(3) of the Code.

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.

The filing of an application for extension of time to file U.S. Fiduciary Income Tax Return and payment of estimated tax for an estate based on a calendar year establishes a calendar year accounting period for the estate.

Rev. Rul. 69–563

A, an individual, died in August 1968. On April 1, 1969, the executor of the estate filed Form 2758, Application for Extension of Time to file U.S. Fiduciary or Partnership Return, and paid 25 percent of the estimated tax for the period of the estate beginning on the date of *A*'s death and ending December 31, 1968, as provided in section 6081(a) of the Internal Revenue Code of 1954. Extension of time until June 15, 1969, was granted. However, the U.S. Fiduciary Income Tax Return (Form 1041), filed on June 14, 1969, was based upon a fiscal year ended April 30, 1969. *Held,* the estate has established a calendar year accounting period within the meaning of section 441(c) of the Code and sections 1.441–1(c) and 1.443–1(a)(2) of the Income Tax Regulations, since the Form 2758 filed by the executor indicated a calendar year ending December 31, 1968. See Revenue Ruling 57–589, C.B. 1957–2, 298, wherein the information contained in Form 7004, Application for Automatic Extension of Time to File U.S. Corporation Income Tax Return, filed by a corporation was sufficient to establish a calendar year accounting period for the corporation. In the instant case, the executor must file the first income tax return (Form 1041) for the estate covering the period beginning with the date of *A*'s death and ending December 31, 1968. Any change to another accounting period requires the prior approval of the Commissioner. See section 442 of the Code and section 1.442–1 of the regulations.

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26 CFR 1.441–1: Period for computation of taxable income.

Self-employment tax liability of an individual who has two taxable periods in one calendar year. See Rev. Rul. 69–410, page 167.

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.

Taxpayers wishing to change their accounting practice for valuing parts recovered and rebuilt from their equipment, for Federal income tax purposes. See Rev. Rul. 69–370, page 34.

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

Whether a domestic corporation operating a funeral home should use the accrual method of accounting. See Rev. Rul. 69–537, page 109.

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

Change in taxpayers method of accounting for taxes imposed on the employer under the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA). See Rev. Rul. 69–587, page 108.

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

Procedures for changing certain methods of computing depreciation. See Rev. Proc. 69–29, page 311.

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

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Section 451.—General Rule for Taxable Year of Inclusion

26 CFR 1.451–1: General rule for taxable year of inclusion.

A refund of Colorado income tax resulting from a net operating loss carryback is accruable in the income of an accrual method taxpayer for the taxable year of the loss which gives rise to the refund.

Rev. Rul. 69–372

Advice has been requested whether, for Federal income tax purposes, a refund of Colorado State income taxes resulting from a net operating loss carryback should be included in the income of a taxpayer using the accrual method of accounting in the taxable year of the loss giving rise to the refund or in a later year in which the claimed refund is approved or received.

For taxable years beginning after December 31, 1964, the State of Colorado permits a net operating loss deduction for State income tax purposes in the same manner that it is allowed under the Internal Revenue Code of 1954. The amount of the net operating loss that may be carried for-

ward and carried back for Colorado State income tax purposes shall be that portion of the Federal net operating loss allocated to Colorado in the taxable year that the net operating loss is sustained. Section 138–1–59, Article 1, Colorado Revised Statutes, as reenacted by Ch. 95, Laws 1964.

In order to obtain a refund, the taxpayer must file a claim for refund not later than one year after expiration of time provided for filing a claim for refund of Federal income tax. Section 138–9–7 of the Colorado Statute. However, for taxable years beginning after December 31, 1967, a taxpayer may file an application for a tentative carryback adjustment for the prior taxable year or years affected by a net operating loss carryback, as determined under section 138–1–59 of the Colorado Statute from any taxable year. Section 138–1–61 of the Colorado Statute. Under the provisions of the Colorado law both the claim and application are generally subject to the same rules as under the Internal Revenue Code.

Section 451 of the Code provides, in part, that the amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Section 1.451–1(a) of the Income Tax Regulations provides, in part, that, under the accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy.

The inclusion in gross income will be required even though it may be necessary for additional acts to be performed by third persons, if it is reasonable to expect that these acts will be performed. See Rev. Rul. 65–190, C.B. 1965–2, 150, and the cases cited therein.

Where a net operating loss is sustained for a particular taxable year, the amount of the loss can be calculated with reasonable accuracy from the books and accounts of the taxpayer. If a claim for refund or an application for tentative carryback adjustment is properly submitted, it can reasonably be expected that the claim will be approved by the Colorado taxing authorities.

Accordingly, for Federal income tax purposes, a refund of Colorado income tax resulting from a net operating loss carryback is properly accruable in the income of a taxpayer using the accrual method of accounting for the taxable year of the loss which gives rise to the refund, since all of the events have occurred during such year which fix the right to the refund and the amount can be determined with reasonable accuracy.

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26 CFR 1.451–1: General rule for taxable year of inclusion.

A partnership composed of physicians that, pursuant to an agreement, furnishes medical services to a nonprofit medical and hospital service corporation is not a party to the corporation's retirement plan provided for the physicians and derives no gross income therefrom; Revenue Ruling 69–49 superseded.

Rev. Rul. 69–474

A nonprofit corporation engaged in operating a medical and hospital service program entered into an agreement with a partnership composed of physicians (the "Group") whereby the Group agrees to furnish the medical services required to satisfy the medical service obligations provided in the corporation membership contracts. These services are rendered without intervention in any manner by the corporation. There is no contractual relationship between the physicians and the patients. The agreement provides that the corporation shall determine the monthly average number of members entitled to medical services to be provided by the Group and shall pay to the Group an amount equal to such average membership multiplied by the per member price in effect for the month. Thus, the remuneration is not related to any particular service provided to any particular patient.

The corporation also established a retirement plan that provides a monthly pension for life to each participating physician, whether a partner or employee of the partnership, who retires because of age or disability, such pension contingent upon the express conditions of the plan being fully met at the time each monthly retirement payment is due. The retirement plan as constituted was exclusively between the individual physicians and the corporation. The corporation is not obligated with respect to the plan to make any payments prior to an actual retirement. The plan is not funded by a trust arrangement, or other arrangement, to which the physicians will have any prior or privileged claim.

Held, since the corporation has no obligation to pay any currently fixed or ascertainable amounts to or under the retirement plan, since the plan is not funded in any way, and since there is no contractual relationship between the partnership and the corporation as to the retirement plan, the partnership does not derive any gross income, by reason of any interest in or right under the retirement plan. When the corporation becomes obligated to make payments under the retirement plan to a physician eligible under the plan to receive such payments, by reason of his interest in and rights under the retirement plan, he derives gross income at such time or times as he receives the payments.

Compare Revenue Ruling 69–50, C.B. 1969–1, 140, which holds, under the facts therein, that when a nonprofit corporation insuring medical expenses of its subscribers, pursuant to an election made by a cash-basis participating physician, withholds a stated percentage of all payments that become due the physician, these amounts must be included in the gross income of the physician in the taxable year withheld.

Revenue Ruling 69–49, C.B. 1969–1, 138, which contains facts substantially

similar to those of the instant case is hereby superseded.

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26 CFR 1.451–1: General rule for taxable year of inclusion.

Whether title to merchandise passes prior to the acceptance of sight drafts. See Rev. Rul. 69–618, page 110.

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26 CFR 1.451–1: General rule for taxable year of inclusion.

Commissions deposited with a court. See Rev. Rul. 69–642, page 9.

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26 CFR 1.451–2: Constructive receipt of income.
(Also Section 404; 1.404(a)–1.)

Incentive bonuses awarded to employees at the discretion of the corporate-employer, to be paid at a designated future time in accordance with provisions of a nonqualified unfunded deferred compensation plan, constitute income in the taxable year actually received or made available.

Rev. Rul. 69–649

Advice has been requested as to when, under the circumstances described below, an employee receiving awards in accordance with the provisions of a non-qualified unfunded deferred compensation plan is subject to tax on the amounts awarded.

Prior to 1967 the employer-corporation awarded an annual incentive bonus to key employees and paid these awards in cash shortly after the amount of the award was determined.

During 1967 the board of directors of the corporation approved a supplementary retirement plan (a nonqualified unfunded deferred compensation plan) under which any part or all of any employee's incentive bonus award for 1967 and subsequent years will be paid at a designated future time, rather than currently in cash as under the corporation's prior practice.

The selection of employees to participate in the plan and the amount of bonus awarded participating employees is determined by a committee of the board of directors of the corporation who are neither officers nor employees of the corporation or of any of its affiliates. This committee also has the sole discretion to defer all or any part of any employee's incentive bonus award.

No employee has any right to receive any incentive bonus for any year (whether to be paid in cash or to be deferred) until such time, if any, as the above described committee makes an award to him. No employee has any election as to the amount or time of payment of his award for any year. Further, the last of any such payment(s) must be paid no later than 10 years from the normal retirement date of the employee.

The obligations of the corporation under this supplementary retirement plan are merely contractual and are not funded or secured. The awards are nonassignable. However, in the case of death the awards are payable to the employee's designated beneficiary.

The employee-taxpayer in the instant case was awarded an incentive bonus under the plan that is to be paid to him in a designated future year.

Section 1.451–2 of the Income Tax Regulations provides, in part, that income is constructively received in the taxable year during which it is credited to the taxpayer's account, set apart for him, or otherwise made available so that he may obtain it at any time. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

In the instant case, it is held that the incentive bonus award to the employee, which is deferred under this supplementary retirement plan, is not includible in income in the year earned. The amount thus deferred is includible in the gross income of the recipient in the later taxable year(s) in which it is actually received by or otherwise made available to him, whichever is earlier.

The employer-corporation is entitled to deduct this deferred bonus award under section 404(a)(5) of the Internal Revenue Code of 1954 only in the taxable year in which payments are actually made to the employee or his legal representative, to the extent such payments are ordinary and necessary expenses within the meaning of section 162 of the Code.

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26 CFR 1.451–2: Constructive receipt of income.
(Also Section 404; 1.404(a)–1.)

Treatment of amounts deferred pursuant to an employment contract executed by an employee and his employer corporation under which the employee may elect to defer receipt of a portion of his scheduled salary for distribution to him following termination of his full-time employment.

Rev. Rul. 69–650

Advice has been requested regarding the treatment for Federal income tax purposes of amounts deferred under the contractual arrangement described below.

An employee, on the cash receipts and disbursements method of accounting, and his employer-corporation, on the accrual method of accounting, executed an employment contract under which the employee may irrevocably elect to defer receipt of a portion of his following year's scheduled salary.

The contract provides that each full-time employee, including officers (excluding the chairman of the board), who attains the age of 40 on or before any December 31 and who earns a specified amount in normal compensation during the twelve-month period ending with such December 31 may irrevocably elect to defer receipt of a portion of his scheduled salary for the twelve-month period following such December 31. Normal compensation is defined in the contract as the scheduled salary payable for an employee's services rendered to the corporation.

Under the contract, each employee may elect, in the year prior to the year in which the amounts are earned, to defer receipt of either 5 percent or 10 percent of his scheduled salary. For

each employee so electing, the corporation establishes a deferred compensation account and credits to such account the amount the employee elected to defer. The amounts deferred are to be satisfied from the general corporate funds which are subject to the claims of the creditors.

The amount in an employee's account is to be distributed to him in installments on January 1 of each of the 10 years next following the date of termination of his regular full-time employment. Distribution in a like manner is also to be made after the expiration of any period of six calendar months during which the employee is disabled so as to be unable to render full-time services to the corporation. If the employee should die prior to receiving the total amount credited to his account, the entire balance remaining is to be promptly paid to his legal representative.

The employee in the instant case elected, in accordance with the employment contract, to defer a portion of his scheduled salary which would otherwise be received during the twelve-month period following December 31, 1967.

Section 1.451–2(a) of the Income Tax Regulations provides, in part, that income is constructively received in the taxable year during which it is credited to the taxpayer's account, set apart for him, or otherwise made available so that he may obtain it at any time. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

In the instant case, it is held that the portion of the employee's salary deferred in accordance with the terms of the described contract is not includible in income in the year earned (1968). The amount thus deferred is includible in the gross income of the recipient in the later taxable year(s) in which it is actually received by or otherwise made available to him, whichever is earlier.

The employer-corporation, although on the accrual method of accounting, is entitled to deduct this deferred amount under section 404(a)(5) of the Internal Revenue Code of 1954 only in the taxable year in which payments are actually made to the employee or his legal representative, to the extent such payments are ordinary and necessary expenses within the meaning of section 162 of the Code.

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26 CFR 1.451–2: Constructive receipt of income.

Whether interest credited by a savings and loan association with respect to a savings deposit certificate is includible in the depositor's gross income prior to the taxable year in which the original term of the certificate has been concluded. See Rev. Rul. 69–638, page 139.

Section 453.—Installment Method

26 CFR 1.453–1: Installment method of reporting income.

A taxpayer may not elect to report income from the sale of real property on the installment method where the total purchase price is payable in a lump sum in a taxable year subsequent to the year of sale.

Rev. Rul. 69–462

Advice has been requested whether, under the circumstances described below, a taxpayer may elect to report income from the sale of real property on the installment method of accounting under section 453 of the Internal Revenue Code of 1954.

The taxpayer sold, at a gain, 60 acres of land. No payment was received in the year of sale. The contract of sale does not provide for multiple payments of the price by the purchaser. The entire purchase price, which is represented by the buyer's negotiable promissory note secured by a purchase money mortgage, is payable in a lump sum 10 years from the date of sale. Pursuant to the terms of the note, interest is paid annually on each anniversary date of the note.

Section 453(a) of the Code provides that a person who regularly sells or otherwise disposes of personal property on the installment plan may report as income therefrom 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 payment for the property is completed, bears to the total contract price.

Section 1.453–2(b) of the Income Tax Regulations provides that section 453(a) of the Code is applicable only to those sales of personal property that, by their terms and conditions, contemplate that they will be paid for in two or more payments.

Section 453(b) of the Code provides that income from a sale or other disposition of real property may be reported "on the basis and in the manner" prescribed in section 453(a) of the Code. Thus, while section 453(b) of the Code does not expressly state that multiple payments of the purchase price of real property is a prerequisite to reporting income from such sales on the installment method, such a requirement is implicit in section 453(b) of the Code inasmuch as income from sales of personal property by dealers may be returned on the installment method only if the plan of sale contemplates multiple payments of the purchase price and income from sales of real property may be returned "on the basis" prescribed for dealers; i.e., as each of the payments against the purchase price is actually received.

In *Thomas F. Prendergast, Executor,* v. *Commissioner,* 22 B.T.A. 1259 (1931), the vendor sold real estate receiving therefor two 10-year secured mortgage bonds of the vendee. Pursuant to the terms of the bonds, interest was paid semi-annually in each year, and the principal of both bonds was payable on the same specified date. In concluding that the income from the sale was not reportable on the installment method, within the meaning of section 212(d) of the Revenue Act of 1926 (corresponding to section 453 of the 1954 Code), the United States Board of Tax Appeals indicated that multiple payments of the purchase price were inherent in the concept of reporting income on the "installment"

method of accounting. The Board stated as follows:

An "installment" is defined in Webster's Dictionary as "A portion of a debt or sum of money which is divided into portions that are made payable at different times. The system of making sales, as in conditional sales, for a sum made payable in portions at stated intervals is often called the installment plan." An "installment payment" is defined in Corpus Juris, vol. 32, p. 939, as:

A partial payment on account of a debt due; the arrangement of a payment of a sum of money by fixed portions at stated times; the *payment* or the time appointed for payment *of different portions of a sum of money,* which by agreement of the parties, instead of being payable in gross, at one time, is to be *paid in parts,* at certain stated times. (Emphasis added.)

In *James McCutcheon & Co.* v. *Commissioner,* 30 B.T.A. 1177 (1934), the United States Board of Tax Appeals, in concluding that several sales of stock were not sales on the installment plan, cited the principle in the *Prendergast* case with approval stating:

In *Thomas F. Prendergast, Executor,* 22 B.T.A. 1259, we considered the question as to the meaning of the word "installment" and reached the conclusion that where only one single payment was provided for in the sales agreement the transaction was not an installment sale.

In *Walnut Realty Trust,* v. *Commissioner,* 23 B.T.A. 850 (1931), acquiescence, C.B. X–2, 73 (1931), it was held that since the consideration received by the taxpayer-vendor consisting of cash, notes of third parties endorsed to the vendor without recourse, certain equities in real property, and the assumption of a first mortgage and taxes did not provide for installment payments, the transaction was not an "installment sale."

Revenue Ruling 56–587, C.B. 1956–2, 303, holds that a taxpayer who is entitled, under terms of a sales contract with a dealer, to receive the sales price of goods upon the sale and delivery by the dealer, but not later than a particular date, may not treat such transactions as installment sales, since no provision was made in the contract for payment of fixed amounts at stated intervals. That Revenue Ruling states as follows:

"An installment sale is a sales arrangement whereby the selling price is collected in *periodical* installments." Finney and Miller, Principles of Accounting—Advanced, 4th Edition, p. 118 (Emphasis added) Installments are defined by Black's Law Dictionary, 4th Edition, as *"Different portions of the same debt payable at different* successive periods as agreed." Webster's New International Dictionary states that: "The system of making *sales,* as in conditional sales, *for a sum made payable in portions* at stated intervals, is often called the installment plan." (Emphasis added.)

It is held that the taxpayer in the instant case may not elect to report the income from the sale of real property on the installment method of accounting since the total amount to be received for the property is to be received in a lump sum in a taxable year subsequent to his taxable year of sale. The installment method of reporting income is applicable only to those sales of real property that, by their terms and conditions, provide for two or more payments of portions of the purchase price in two or more taxable years.

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.

The entire amount of a workmen's compensation award payable over several years is deductible by an accrual basis partnership in the taxable year in which the award was determined; I.T. 1263 superseded.

Rev. Rul. 69–429 [1]

A partnership that keeps its books on the accrual method of accounting was required to pay to one of its employees who was injured a sum in weekly installments extending over a period of several years. Such sum was fixed by the Industrial Commission under the Workmen's Compensation Act of the State wherein the partnership is located.

Held, since the partnership books were kept on an accrual method, the full amount of the award became an accrued liability at the time it was fixed by the Industrial Commission and is deductible by the partnership for the taxable year in which the award was determined.

I.T. 1263, C.B. I–1, 123 (1922), is superseded, since the position set forth therein is restated under the current statute and regulations in this Revenue Ruling.

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26 CFR 1.461–1: General rule for taxable year of deduction.
(Also Sections 446, 3111, 3121, 3301; 1.446–1, 31.3111–3, 31.3121(a)–1, 31.3121(a)–2, 31.3301–1, 31.3301–2.)

FICA and FUTA taxes attributable to accrued bonuses and vacation pay of an accrual method employer are deductible in the taxable year in which they are actually paid.

Rev. Rul. 69–587

Advice has been requested with respect to the proper year of accrual of taxes imposed on an employer by the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA) on vested bonuses and vacation pay under the circumstances described below.

A taxpayer, using the accrual method of accounting, maintains a vested but unfunded, bonus and vacation pay plan for its employees. The taxpayer accrues and deducts FICA and FUTA taxes that it believes would be due as a result of the plan in the year in which it becomes irrevocably liable to its employees for the underlying

[1] Prepared pursuant to Rev. Proc. 67–6 C.B. 1967–1, 576.

bonuses and vacation pay. The taxpayer makes the bonus payments and the employees take their vacations during the following year.

Section 461 of the Internal Revenue Code of 1954 provides, in general that, for Federal income tax purposes, the amount of any allowable deduction or credit shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

Section 1.461–1(a)(2) of the Income Tax Regulations provides that, under an accrual method of accounting, an expense is deductible for the taxable year in which all the events have occurred which determine the fact of the liability and the amount thereof can be determined with reasonable accuracy.

In the instant case, the bonuses and vacation pay are wages for FICA and FUTA purposes. Sections 3121 and 3306 of the Code and sections 31.3121(a)–1 and 31.3306(b)–1 of the Employment Tax Regulations. The FICA employer tax attaches at the time wages are paid or constructively paid by the employer. Section 3111 of the Code and sections 31.3111–3 and 31.3121(a)–2 of the Employment Tax Regulations. The FUTA tax is imposed on every "employer" and is measured by the amount of wages paid by the employer during the calendar year. Section 3301 of the Code and sections 31.3301–1 and 31.3301–2 of the Employment Tax Regulations. Thus, it is not until the following year when the bonus and vacation payments are made that the fact of liability is established for FICA and FUTA taxes with respect to such bonuses and vacation pay.

Accordingly, in the instant case, the FICA and FUTA taxes attributable to the accrued bonuses and vacation pay are deductible only for the taxable year in which such bonuses and vacation amounts are actually paid. However, any change in the taxpayer's present method of accounting for FICA and FUTA taxes is a change in method of accounting under section 446 of the Code and the regulations thereunder.

26 CFR 1.461–1: General rule for taxable year of deduction.

Deductibility of amounts set aside as a reserve for self-insurance. See Rev. Rul. 69–512, page 24.

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26 CFR 1.461–1: General rule for taxable year of deduction.

Year of deduction of compensatory damage awards required to be paid under decree from the National Labor Relations Board. See Rev. Rul. 69–547, page 24.

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

Whether contested but paid Federal income taxes are allowable as an adjustment to the taxable income of a personal holding company. See Rev. Rul. 69–620, page 137.

Subpart D. Inventories

Section 471.—General Rule for Inventories

26 CFR 1.471–1: Need for inventories.

Real estate held for sale by a taxpayer engaged in the real estate business cannot be inventoried in computing taxable income; O.D. 848 superseded.

Rev. Rul. 69–536 [1]

A taxpayer is engaged in the real estate business and holds real estate for sale to customers.

Held, the taxpayer in computing taxable income is not permitted to inventory real estate held for sale. See *Atlantic Coast Realty Co.* v. *Commissioner,* 11 B.T.A. 416 (1928).

O.D. 848, C.B. 4, 47 (1921), is superseded since the position stated therein is restated under the current statute and regulations in this Revenue Ruling.

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26 CFR 1.471–1: Need for inventories.
(Also Section 446; 1.446–1.)

A cash method funeral home that maintains an inventory of caskets for sale should use the accrual method of accounting with respect to the purchase and sale of such caskets.

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

Rev. Rul. 69–537

Advice has been requested whether the taxpayer, a domestic corporation, operating a funeral home should (1) report caskets on hand and available for sale at the end of the taxble year as inventory within the meaning of section 471 of the Internal Revenue Code of 1954, and (2) compute taxable income on the accrual basis pursuant to section 446 of the Code.

The taxpayer has consistently used the cash receipts and disbursements method of computing income. An inventory of caskets is maintained at all times. The cost of the caskets is deducted as an expense in the year the taxpayer pays for them whether they are used, sold, or held in inventory. The taxpayer holds title to all caskets in his inventory and none are held on consignment. Each casket has a selling price to the public that includes not only the cost of the casket, but also the complete funeral service of embalming, chapel service, and transportation of the body to the grave site. Occasionally, the taxpayer may sell a casket without providing the complete funeral service, i.e., where the body is being shipped to another location.

Section 1.446–1(a)(2) of the Income Tax Regulations provides, in part, that no uniform method of accounting can be prescribed for all taxpayers. However, no method of accounting is acceptable unless, in the opinion of the Commissioner, it clearly reflects income. Section 1.471–1 of the regulations provides that in order to reflect taxable income correctly inventories are necessary in every case in which the production, purchase or sale of merchandise of any kind is an income-producing factor. Merchandise should be included in inventory only if title thereto is vested in the taxpayer. The regulations also provide that the accrual method of accounting must be used with regard to the purchase and sale of such inventories.

Section 1.162–3 of the regulations provides, in pertinent part, for the deduction of materials and supplies only

in the amount actually consumed. However, if they are of an incidental nature for which no record of consumption is kept or for which no physical inventories at the beginning and end of the year are taken, then such expenses may be deducted from gross income in the taxable year purchased provided the taxable income is clearly reflected by this method.

In the instant case the taxpayer keeps an inventory of the caskets on hand. Also, the sale of caskets is an integral part of the business and is of an income-producing nature. Only on rare occasions, when a body would be shipped to the taxpayer from another part of the country, would the taxpayer furnish the funeral service without the use of one of his own caskets.

Accordingly, caskets held by the taxpayer in the instant case are to be included in inventory pursuant to the provisions of section 471 of the Code. Further, the taxpayer, in order to clearly reflect income, should use the accrual method of accounting with respect to the purchase and sale of such caskets. However, any change in the taxpayer's present method of accounting is a change in method of accounting under section 446 of the Code and the regulations thereunder.

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26 CFR 1.471–1: Need for inventories.
(Also Section 451; 1.451–1.)

Merchandise on foreign consignment, accompanied by bills of lading and sight drafts, must be included in the seller's inventory until the purchaser or his agent accepts the drafts; I.T. 2001 superseded.

Rev. Rul. 69–618 [1]

The purpose of this Revenue Ruling is to update and restate under the current statute and regulations the position set forth in I.T. 2001, C.B. III–1, 57 (1924).

The question presented is whether merchandise sold by the taxpayer under the circumstances described below is to be included in the taxpayer's inventory.

M, a domestic corporation, sold merchandise to *X*, a foreign firm located in a foreign country. The merchandise was shipped to *X* in the foreign country in December of 1966. Bills of lading and sight drafts for the purchase price were sent by *M* to its agent in the foreign country for presentation to foreign bank *O* which had guaranteed payment for the merchandise. Due to financial difficulties and existing high currency exchange rates the sight drafts were never accepted by *O* as guarantor and the bills of lading were never out of the possession of *M*'s agent.

X made a partial payment on the purchase price early in 1967; however, the merchandise remained in the control of *M*. *X* did not make another payment but contested the quality of the merchandise and in order to secure commercial and chemical examination was required to deposit in escrow the balance of the purchase price. Litigation ensued, in which it was determined that some of the merchandise did not meet specifications and in June 1968 a final settlement was made between *M* and *X* which gave *X* title to the merchandise.

Section 1.471–1 of the Income Tax Regulations provides, in pertinent part, that merchandise should be included in the inventory only if the title thereto is vested in the taxpayer. The seller should include in his inventory goods under contract for sale but not yet segregated and applied to the contract and goods out upon consignment, but should exclude from inventory goods sold, title to which has passed to the purchaser.

In the instant case the merchandise under contract had been segregated and shipped. However, the acceptance of the sight drafts is a condition precedent to the passing of title and the drafts were never accepted by *O* or *X*.

Accordingly, in the instant case no sale took place in the taxable years 1966 or 1967. Under the circumstances the merchandise would be carried in the inventory of *M* for 1966 and 1967 according to the inventory valuation method used by *M* and any gain or loss from the final disposition of the merchandise in 1968 would then be properly reflected in *M*'s income for 1968.

I.T. 2001 is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

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26 CFR 1.471–3: Inventories at cost.

Overtime costs incurred for direct and indirect labor in excess of the manufacturer's average anticipated costs are a part of the cost of production and must be taken into account in valuing inventories.

Rev. Rul. 69–373

Advice has been requested whether certain overtime costs are to be taken into account in the valuation of inventories, under the circumstances described below.

The taxpayer, a manufacturer, experienced such a rapid growth that it could not keep up with the demand for its product. In order to alleviate the situation, an overtime schedule was maintained to increase production. Overtime premium costs (overtime) were incurred representing payments made for direct and indirect labor in manufacturing its product. As a result there was an excess of overtime premium costs over the taxpayer's average anticipated costs, amounting to 1,000*x* dollars.

The specific question presented is whether, the 1,000*x* dollars is currently deductible or must be considered as part of production costs, to be taken into account in the valuation of the taxpayer's inventories.

Section 471 of the Internal Revenue Code of 1954 provides that, whenever in the opinion of the Secretary or his delegate the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer on such

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

basis as the Secretary or his delegate may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

Section 1.471–3(c) of the Income Tax Regulations, relating to the valuation of inventories at cost, provides that cost means, in the case of merchandise produced by the taxpayer since the beginning of the taxable year, (1) the cost of raw materials and supplies entering into or consumed in connection with the product, (2) expenditures for direct labor, and (3) indirect expenses incident to and necessary for the production of the particular article, including in such indirect expenses a reasonable proportion of management expenses, but not including any cost of selling or return on capital, whether by way of interest or profit.

The fact that payments for overtime produce an actual cost that is in excess of anticipated cost does not change the character of the payments.

In the instant case, it is held that the 1,000x dollars constitute payments made for direct and indirect manufacturing labor costs. Accordingly, such costs are properly a part of the cost of production, to be taken into account by the taxpayer in valuing its inventories.

See *Sears Oil Co., Inc.* v. *Commissioner,* 359 F. 2d 191 (1966), in which the court applied a similar principle in holding that bonus payments paid to a manufacturer for early delivery of barges had to be capitalized as part of the purchase price.

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26 CFR 1.471–3: Inventories at cost. (Also Section 61; 1.61–3.)

In valuing inventory at cost, the average of cash discounts received may not be deducted from the invoice price of goods on hand, nor may reportable cash discounts earned be decreased by amounts representing estimated cash discounts received; O.D. 326 and S.M. 5281 superseded.

Rev. Rul. 69–619 [1]

The purpose of this Revenue Ruling is to update and restate under the current statute and regulations, the position set forth in S.M. 5281, C.B. V–1, 17 (1926), and O.D. 326, C.B. 1, 56 (1919).

The question presented is whether, under the circumstances described below, the average of the cash discounts received during the taxable year may be used under the provisions of section 1.471–3(b) of the Income Tax Regulations to arrive at cost for inventory purposes.

M, a domestic corporation, following its consistent practice valued its inventory for the taxable year at cost i.e., invoice price less trade or other discounts other than cash. Cash discounts were carried in a discount account not being deducted from the invoice price. At the end of the taxable year *M* determined the average amount of the cash discounts received during the year and reduced the inventory on hand at the end of the taxable year by deducting from the invoice price of such goods the average amount of cash discount received on such merchandise.

Section 1.471–3(b) of the regulations provides, in pertinent part, that cost means, in the case of merchandise purchased since the beginning of the taxable year, the invoice price less trade or other discounts (except strictly cash discounts approximating a fair interest rate, which may be deducted or not at the option of the taxpayer, provided a consistent course is followed).

Section 1.471–3(b) of the regulations is to be construed literally. *M*'s election under this regulation is limited to strictly cash discounts which approximate a fair rate of interest, provided the course so elected is uniformly followed.

Accordingly, *M* may not, in valuing its inventory for the taxable year, deduct from the invoice price of the merchandise on hand at the close of the taxable year the average amount of cash discount received on such merchandise. Neither may the amount of cash discount earned, to be reported as income, be decreased by any amount representing the estimated cash discount received on merchandise on hand at the close of the taxable year. Whether the cash discount approximates a fair interest rate, within the meaning of section 1.471(3)(b) of the regulations, will be determined upon the facts in the individual case.

S.M. 5281 and O.D. 326 are superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

Section 472.—Last-In, First-Out Inventories

26 CFR 1.472–1: Last-in, first-out inventories.

The July 1969 Bureau of Labor Statistics price indexes are acceptable for use by department stores employing the retail and last-in, first-out methods of valuing inventories.

Rev. Rul. 69–504

The following price indexes for July 1969, published by the Bureau of Labor Statistics on September 2, 1969, for use by department stores employing the retail inventory and last-in, first-out inventory method, are accepted by the Internal Revenue Service pursuant to section 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 June 30, 1969, and July 31, 1969.

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, food, 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	July 1969	July 1968	Percent change from July 1968 to July 1969 [1]
I	Piece goods	225.5	217.0	3.9
II	Domestics and draperies	240.5	232.4	3.5
III	Women's and children's shoes	338.5	322.4	5.0
IV	Men's and boys' shoes	324.4	308.0	5.3
V	Infants' wear	200.2	190.8	4.9
VI	Women's underwear	206.6	199.5	3.6
VII	Women's and girls' hosiery	160.3	160.0	.2
VIII	Women's and girls' accessories	240.0	229.6	4.5
IX	Women's outerwear and girls' wear	230.3	215.4	6.9
X	Men's clothing	307.2	281.3	9.2
XI	Men's furnishings	235.8	226.6	4.1
XII	Boys' clothing and furnishings	252.2	241.9	4.3
XIII	Jewelry	237.8	223.7	6.3
XIV	Notions	219.3	204.4	7.3
XV	Toilet articles and drugs	239.8	228.6	4.9
XVI	Furniture and bedding	284.0	268.3	5.9
XVII	Floor covering	209.0	205.9	1.5
XVIII	Housewares	295.6	278.5	6.1
XIX	Major appliances	137.5	132.8	3.5
XX	Radio and television sets	109.5	109.8	—.3
	Groups I—XV: Soft goods	246.8	234.2	5.4
	Groups XVI—XX: Durable goods	230.9	220.9	4.5
	Store total	242.1	230.5	5.0

[1] Absence of a minus sign before percentage change in this column signifies price increase.

Part III. Adjustments

Section 482.—Allocation of Income and Deductions Among Taxpayers

26 CFR 1.482–1: Allocation of income and deductions among taxpayers.

Treatment under section 482 of the Code of a bargain sale transaction between related corporations where such sale had as one of its principal purposes the avoidance of Federal income tax and resulted in a significant shifting of income.

Rev. Rul. 69–630

Advice has been requested as to the treatment of a "bargain sale" between two corporate entities controlled by the same shareholder(s).

A, an individual, owns all of the stock of *X* corporation and all of the stock of *Y* corporation. In 1967, *A* caused *X* to sell certain of its property to *Y* for less than an arm's length price. It has been determined that such sale had as one of its principal purposes the avoidance of Federal income tax and resulted in a significant understatement of *X*'s taxable income.

Section 482 of the Internal Revenue Code of 1954 provides authority to distribute, apportion, or allocate gross income, deductions, and credits among related organizations, trades, or businesses if it is necessary in order to clearly reflect the income of such entities or to prevent the evasion of taxes.

Section 482 of the Code applies to bargain sale transactions between brother-sister corporations that result in significant shifting of income. Where an allocation is made under section 482 of the Code as a result of a bargain sale between brother-sister corporations, the amount of the allocation will be treated as a distribution to the controlling shareholder(s) with respect to the stock of the entity whose income is increased and as a capital contribution by the controlling shareholder(s) to the other entity involved in the transaction giving rise to the section 482 allocation.

Accordingly, in the instant case, the income of *X* for 1967 will be increased under section 482 of the Code to reflect the arm's length price of the property sold to *Y*. The basis of the property in the hands of *Y* will also be increased to reflect the arm's length price. See section 1.482–1(d) of the Income Tax Regulations. Furthermore, the amount of such increase will be treated as a distribution to *A*, the controlling shareholder, with respect to his stock of *X* and as a capital contribution by *A* to *Y*.

Because the transaction giving rise to the section 482 allocation had as one of its principal purposes the avoidance of Federal income tax, it is not subject to the provisions of Revenue Procedure 65–17, C.B. 1965–1, 833, as amended by Revenue Procedure 65–17, Amendment I, C.B. 1966–2, 1211. Revenue Procedure 65–17, among other things, permits a qualifying United States taxpayer, whose taxable income has been increased by reason of an allocation under section 482 of the Code to receive payment from the entity from, or to, which the allocation of income, or deductions, was made of an amount equal to a part, or all, of the amount allocated, without further income tax consequences. However, Sec. 3.02 of Revenue Procedure 65–17 states that the treatment provided by the Revenue Procedure is available for taxable years beginning after December 31, 1962 (amended by Revenue Procedure 65–17, Amendment I, to read "December 31, 1964") only if the transaction giving rise to the section 482 allocation did not have as one of its principal purposes the avoidance of Federal income tax.

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.

Issuance of opinion letters involving definition of "compensation" in master or prototype plans intended to integrate with Social Security benefits. See Rev. Proc. 69–20, page 303.

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26 CFR 1.501(a)–1: Exemption from taxation.

Elimination of advance determinations as to exemption of employees' trusts that include self-employed individuals, where employers have adopted master or prototype plans previously approved as to form. See Rev. Proc. 69–24, page 306.

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26 CFR 1.501(a)–1: Exemption from taxation.

Procedures for requests for exemption of trusts forming part of master and prototype pension and profit-sharing plans designed to include self-employed individuals. See Rev. Proc. 69–30, page 312.

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26 CFR 1.501(c)(2)–1: Corporations organized to hold title to property for exempt organizations.

A title holding corporation that derives income from rental of real property to the general public is not precluded from exemption under section 501(c)(2) of the Code.

Rev. Rul. 69–381

The Internal Revenue Service has been asked whether the corporation described below is exempt from Federal income tax under section 501(c)(2) of the Internal Revenue Code of 1954.

The corporation holds title to a building containing offices that are rented on annual leases to the general public. It collects the rents, pays the expenses incident to operation and maintenance of the building, and turns over the remainder to its parent, a charitable organization exempt from Federal income tax under section 501(c)(3) of the Code. The title holding company renders no substantial services to the tenants other than normal maintenance of the building and grounds. The tenants are not related in any way to the title holding company or the charitable organization for which it holds title.

Section 501(c)(2) of the Code provides for exemption from Federal income tax of corporations organized for the exclusive purpose of holding title to property, collecting income from the property, and turning over the entire amount of the income, less expenses, to an organization which itself is exempt from Federal income tax under section 501 of the Code.

Section 1.501(c)(2)–1(a) of the Income Tax Regulations provides that since a corporation cannot be exempt under section 501(c)(2) if it engages in any business other than that of holding title to property and collecting income therefrom, it cannot have unrelated business taxable income as defined in section 512 other than unrelated business rental income described in section 514. Section 514 of the Code relates to certain leases of real property. Thus it is clear that section 501(c)(2) contemplates that a corporation exempt under its provisions can have income from rental of real property.

The threshold question here is whether the income derived by this corporation from leasing offices in its building is rental income for this purpose.

Section 512(b)(3) of the Code excludes from the determination of unrelated business taxable income rents from real property.

Section 1.512(b)–1(c) of the regulations defines rents for this purpose and states, in part, that payments for the use or occupancy of offices in an office building are generally rentals from real estate. Thus, the income this organization derives is income from rental of real property under the Code and regulations.

The second question is whether a title holding company can receive such income from the general public and retain its exemption under section 501(c)(2) of the Code.

There is nothing in section 501(c)(2) of the Code that prevents corporations exempt under its provisions from renting property to the general public. Moreover, it is considered that the statutory language that requires them to turn over the income from the property to an exempt organization contemplates that income will be received from parties other than the exempt organization for which they hold title.

It is held that income from rental of offices to the general public in the instant case does not preclude exemption from Federal income tax under section 501(c)(2) of the Code. Under the facts stated, this organization qualifies for exemption from Federal income tax under section 501(c)(2) of the Code.

Even though an organization considers itself within the scope of this Revenue Ruling, it must (in order to establish exemption under section 501(c)(2) of the Code) file an application on Form 1026, 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.

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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.

The exempt status of a hospital will not be jeopardized where, after arm's length negotiations, it enters into an agreement with a hospital-based radiologist to compensate him on the basis of a fixed percentage of the departmental income.

Rev. Rul. 69–383

Advice has been requested whether a hospital exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 jeopardizes its exemption by entering into the contractual relationship described below.

After arm's length negotiations, the hospital entered into a written agreement with a radiologist. Under the contract the hospital provides space, equipment, and supplies, and makes nonmedical personnel available to the department of radiology. The radiologist agreed to manage the department, participate in the hospital's educational program, and perform all radiological services required by hospital patients, employees, and students. While the radiologist serves as the professional and administrative head of the hospital's department of radiology, he has no control over, or management authority with respect to, the hospital itself. The hospital, with approval of the radiologist, established the amounts charged to patients for services rendered. The hospital bills and collects the charges. The hospital pays the radiologist a fixed percentage of the department's gross billings, adjusted by an allowance for bad debts. The agreement remains in full force and effect for a term of years, with each party having the right of cancellation upon prior notice.

The amount received by the subject radiologist under the contract described above is not excessive when compared to the amounts received by radiologists having similar responsibilities and handling a comparable patient volume at other similar hospitals.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for charitable, educational, or scientific 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(c)(2) of the Income Tax Regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Under certain circumstances, the use of a method of compensation based upon a percentage of the income of an exempt organization can constitute inurement of net earnings to private individuals. For example, the presence of a percentage compensation agreement will destroy the organization's exemption under section 501(c)(3) of the Code where such arrangement transforms the principal activity of the organization into a joint venture between it and a group of physicians (*Lorain Avenue Clinic* v. *Commissioner,* 31 T.C. 141 (1958)), or is merely a device for distributing profits to persons in control (*Birmingham Business College* v. *Commissioner,* 276 F. 2d 476 (1960)).

However, under the circumstance described above, the radiologist did not control the organization and the agreement was negotiated at arm's length. The amount the radiologist received was reasonable in terms of the responsibilities and activities that he assumed under the contract. For these reasons, it is held that the arrangement entered into between the hospital and the radiologist does not constitute inurement of net earnings to a private individual within the meaning of section 1.501(c)(3)–1(c)(2) of the regulations.

Accordingly, the organization does not for this reason jeopardize its exemption from Federal income tax under section 501(c)(3) of the Code.

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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.

A nonprofit organization that selects students and faculty members who are interested in a particular foreign history and culture and enrolls them at foreign universities qualifies for exemption under section 501(c)(3) of the Code; Revenue Ruling 67–327 distinguished.

Rev. Rul. 69–400

Advice has been requested whether a nonprofit organization formed and operated as described below qualifies for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

The organization was formed to enable students and faculty members of United States schools who have a serious interest or background in a particular foreign history and culture to obtain a better understanding and become more knowledgeable in those matters. The organization accomplishes its purposes by selecting and enrolling qualified individuals in courses of study at foreign universities, arranging for transportation to and from the respective country, and arranging for on-site tours conducted by local scholars to complement classroom study in the particular country. A selection committee ascertains the bona fide nature of the reasons for individuals applying for participation in the organization's program. The organization is financed by fees, grants, and contributions.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)–1(d)(2) of the Income Tax Regulations provides that the term "charitable" includes the advancement of education.

Under these circumstances, by selecting and enrolling participants at various foreign universities, arranging for transportation, and arranging tours that complement classroom studies, it is held that the organization is advancing education. Accordingly, the organization qualifies for exemption from Federal income tax under section 501(c)(3) of the Code.

The facts set forth above are distinguishable from Revenue Ruling 67–327, C.B. 1967–2, 187, wherein the sole purpose and activity of the organization was to arrange group tours for students and faculty members of a university.

Even though an organization considers itself within the scope of this Revenue Ruling, it 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.

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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.

A nonprofit organization formed to help reduce personal bankruptcy by informing the public on personal money management and aiding low-income individuals and families with financial problems is exempt under section 501(c)(3) of the Code.

Rev. Rul. 69–441

Advice has been requested whether a nonprofit organization that operates in the manner described below qualifies for exemption from Federal income tax under section 501(c) (3) of the Internal Revenue Code of 1954.

The organization was formed to help reduce the incidence of personal bankruptcy by informing the public on personal money management and by assisting low-income individuals and families who have financial problems. Its board of directors is comprised of representatives from religious organizations, civic groups, labor unions, business groups, and educational institutions.

The organization provides information to the public on budgeting, buying practices, and the sound use of consumer credit through the use of films, speakers, and publications. It aids low-income individuals and families who have financial problems by providing them with individual counseling and, if necessary, by etablishing budget plans. Under a budget plan, the debtor voluntarily makes fixed payments to the organization. The funds are kept in a trust account and disbursed on a partial payment basis to the creditors, whose approval of the establishment of the plan is obtained by the organization. These services are provided without charge to the debtor. The debtor receives full credit against his debts for amounts paid. The organization does not make loans to the debtors or negotiate loans on their behalf.

The organization's receipts are from contributions, primarily from the creditors participating in the organization's budget plans. However, the creditors are not required to make contributions as a condition of participation. Disbursements are made for general operating expenses.

Section 501(c) (3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for charitable or educational purposes.

Section 1.501(c) (3)–1(d) (2) of the Income Tax Regulations defines the term "charitable" as including relief of the poor and distressed.

Section 1.501(c) (3)–1(d) (3) of the regulations defines the term "educational" as including the instruction of the public on subjects useful to the individual and beneficial to the community.

By aiding low-income individuals and families who have financial problems and by providing, without charge, counseling and a means for the orderly discharge of indebtedness, the organization is relieving the poor and distressed. Furthermore, by providing the public with information on budgeting, buying practices, and the sound use of consumer credit, the organization is instructing the public on subjects useful to the individual and beneficial to the community.

Accordingly, the organization is exempt from Federal income tax under section 501(c) (3) of the Code.

Compare Revenue Ruling 65–299, C.B. 1965–2, 165, which holds that a nonprofit organization formed to advise, counsel, and assist individuals in solving their financial difficulties by budgeting their income and expenses and effecting an orderly program for the payment of their obligations qualifies for exemption from Federal income tax under section 501(c) (4) of the Code (rather than under section 501(c) (3)).

In that case the organization was not engaged in any educational activities, and the families or individuals eligible for assistance were not limited to those who were in need of such assistance as proper recipients of charity.

Even though an organization considers itself within the scope of this Revenue Ruling, it 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.

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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.

A nonprofit organization formed by a group of physicians specializing in heart disease to research the cause and to publish treatments of heart defects qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 69–526

Advice has been requested whether a nonprofit organization formed and operated as described below is exempt from Federal income tax under section 501(c) (3) of the Internal Revenue Code of 1954.

The organization was formed and is operated by a group of physicians specializing in heart defects for the purpose of conducting scientific research into the cause and treatment of cardiac and cardiovascular conditions and diseases.

Patients are referred to the organization by physicians and welfare agencies when it appears that their condition merits special study and

evaluation. Each patient is first examined to ascertain whether his condition falls within the scope of the organization's research goals. If his case meets the criteria, he is accepted without regard to his ability to pay. The data collected from the study of these patients are used by the organization in the development of new methods and procedures for preventing and treating heart defects. The results of the research as well as any medical procedures derived therefrom are made public through publication in professional journals, lectures, and film strips.

The creators conduct their medical practices apart from the organization's research program. Although their private patients are accepted for study on the same criteria as other patients, the majority of the organization's patients have had no prior contact with the creators. The organization's facilities are maintained separately from the facilities of its physician-creators and are used exclusively for the organization's research.

The organization receives its income from fees from patients, contributions, and grants. Fees received from patients do not cover the actual cost of services performed.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for scientific 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)(5)(i) of the Income Tax Regulations provides that an organization organized and operated for scientific purposes can qualify under section 501(c)(3) of the Code only if it serves a public rather than a private interest.

Section 1.501(c)(3)–1(d)(5)(iii) of the regulations provides that scientific research is regarded as carried on in the public interest if such research is directed toward benefiting the public. Examples of scientific research which is directed toward benefitting the public, and, therefore, carried on in the public interest include (1) scientific research carried on for the purpose of obtaining scientific information, which is published in a treatise, thesis, trade publication, or in any other form that is available to the interested public, and, (2) scientific research carried on for the purpose of discovering a cure for a disease.

It is held that by carrying on its research program in the manner described and by making the results of its studies available to the interested public, the organization is operated for scientific purposes within the meaning of section 501(c)(3) of the Code.

Any personal benefit (in the form of increased prestige and enhanced reputation) derived by the physician-creators does not lessen the public benefits flowing from the organization's operations and are not considered to be the type of private interest referred to in section 1.501(c)(3)–1(d)(5)(i) of the regulations.

Accordingly, the organization qualifies for exemption from Federal income tax under section 501(c)(3) of the Code.

Even though an organization considers itself within the scope of this Revenue Ruling, it 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.

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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.

An organization that operates a college book and supply store serving exclusively members of the faculty and student body and refunds its excess earnings to member purchasers qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 69–538

The Internal Revenue Service has been asked whether a nonprofit corporation formed to operate a college book and supply store in the manner described below is exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

The book and supply store sells new and used textbooks and other school supplies. Sales are made only to its membership, which is limited to students and faculty of the college.

The organization attempts to operate at cost. If earnings are realized in excess of operating needs, the excess is refunded annually to members in proportion to their purchases. In the event of dissolution, the remaining assets will be given to an organization exempt from Federal income tax under section 501(c)(3) of the Code.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations that are organized and operated exclusively for charitable or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Revenue Ruling 58–194, C.B. 1958–1, 240, holds that a corporation organized for the purpose of operating a book and supply store and a cafeteria and restaurant on the campus of a State university primarily for the convenience of its student body and the members of its faculty, no part of the earnings of which inures to the benefit of any private shareholder or individual, may be considered to be operated exclusively for educational purposes and may qualify for exemption from Federal income tax under section 501(c)(3) of the Code.

The book and supply store in this case is organized and operated in essentially the same manner as the organization held exempt in Revenue Ruling 58–194, C.B. 1958–1, 240, ex-

cept that it refunds its surplus earnings to its member purchasers.

Since the cash refund is based upon the amount of business transacted with each member, it merely represents a reduction in the price of the books and supplies sold. Therefore, the annual distribution to members does not result in inurement of the organization's net earnings to individuals.

Accordingly, it is held that the organization is exempt from Federal income tax under section 501(c)(3) of the Code.

Even though an organization considers itself within the scope of this Revenue Ruling, it 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.

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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.

Examples illustrate whether a nonprofit hospital claiming exemption under section 501(c)(3) of the Code is operated to serve a public rather than a private interest; Revenue Ruling 56–185 modified.

Rev. Rul. 69–545 [1]

Advice has been requested whether the two nonprofit hospitals described below qualify for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954. The articles of organization of both hospitals meet the organizational requirements of section 1.501(c)(3)-1(b) of the Income Tax Regulations, including the limitation of the organizations' purposes to those described in section 501(c)(3) of the Code and the dedication of their assets to such purposes.

Situation 1. Hospital *A* is a 250-bed community hospital. Its board of trustees is composed of prominent citizens in the community. Medical staff privileges in the hospital are available to all qualified physicians in the area, consistent with the size and nature of its facilities. The hospital has 150 doctors on its active staff and 200 doctors on its courtesy staff. It also owns a medical office building on its premises with space for 60 doctors. Any member of its active medical staff has the privilege of leasing available office space. Rents are set at rates comparable to those of other commercial buildings in the area.

The hospital operates a full time emergency room and no one requiring emergency care is denied treatment. The hospital otherwise ordinarily limits its admissions to those who can pay the cost of their hospitalization, either themselves, or through private health insurance, or with the aid of public programs such as Medicare. Patients who cannot meet the financial requirements for admission are ordinarily referred to another hospital in the community that does serve indigent patients.

The hospital usually ends each year with an excess of operating receipts over operating disbursements from its hospital operations. Excess funds are generally applied to expansion and replacement of existing facilities and equipment, amortization of indebtedness, improvement in patient care, and medical training, education, and research.

Situation 2. Hospital *B* is a 60-bed general hospital which was originally owned by five doctors. The owners formed a nonprofit organization and sold their interests in the hospital to the organization at fair market value. The board of trustees of the organization consists of the five doctors, their accountant, and their lawyer. The five doctors also comprise the hospital's medical committee and thereby control the selection and the admission of other doctors to the medical staff. During its first five years of operations, only four other doctors have been granted staff privileges at the hospital. The applications of a number of qualified doctors in the community have been rejected.

Hospital admission is restricted to patients of doctors holding staff privileges. Patients of the five original physicians have accounted for a large majority of all hospital admissions over the years. The hospital maintains an emergency room, but on a relatively inactive basis, and primarily for the convenience of the patients of the staff doctors. The local ambulance services have been instructed by the hospital to take emergency cases to other hospitals in the area. The hospital follows the policy of ordinarily limiting admissions to those who can pay the cost of the services rendered. The five doctors comprising the original medical staff have continued to maintain their offices in the hospital since its sale to the nonprofit organization. The rental paid is less than that of comparable office space in the vicinity. No office space is available for any of the other staff members.

Section 501(c)(3) of the Code provides for exemption from Federal income tax of organizations organized and operated exclusively for charitable, scientific, 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 any purpose set forth in section 501(c)(3) of the Code unless it serves a public rather than a private interest.

Section 1.501(c)(3)-1(d)(2) of the regulations states that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense.

To qualify for exemption from Federal income tax under section 501(c)(3) of the Code, a nonprofit hospital must be organized and operated exclusively in furtherance of some pur-

[1] Also released as Technical Information Release 1022, dated Oct. 8, 1969.

pose considered "charitable" in the generally accepted legal sense of that term, and the hospital may not be operated, directly or indirectly, for the benefit of private interests.

In the general law of charity, the promotion of health is considered to be a charitable purpose. *Restatement (Second), Trusts,* sec. 368 and sec. 372; IV *Scott on Trusts* (3rd ed. 1967), sec. 368 and sec. 372. A nonprofit organization whose purpose and activity are providing hospital care is promoting health and may, therefore, qualify as organized and operated in furtherance of a charitable purpose. If it meets the other requirements of section 501(c)(3) of the Code, it will qualify for exemption from Federal income tax under section 501(a).

Since the purpose and activity of Hospital *A,* apart from its related educational and research activities and purposes, are providing hospital care on a nonprofit basis for members of its community, it is organized and operated in furtherance of a purpose considered "charitable" in the generally accepted legal sense of that term. The promotion of health, like the relief of poverty and the advancement of education and religion, is one of the purposes in the general law of charity that is deemed beneficial to the community as a whole even though the class of beneficiaries eligible to receive a direct benefit from its activities does not include all members of the community, such as indigent members of the community, provided that the class is not so small that its relief is not of benefit to the community. *Restatement (Second), Trusts,* sec. 368, comment (b) and sec. 372, comments (b) and (c); IV *Scott on Trusts* (3rd ed. 1967), sec. 368 and sec. 372.2. By operating an emergency room open to all persons and by providing hospital care for all those persons in the community able to pay the cost thereof either directly or through third party reimbursement, Hospital *A* is promoting the health of a class of persons that is broad enough to benefit the community.

The fact that Hospital *A* operates at an annual surplus of receipts over disbursements does not preclude its exemption. By using its surplus funds to improve the quality of patient care, expand its facilities, and advance its medical training, education, and research programs, the hospital is operating in furtherance of its exempt purposes.

Furthermore, Hospital *A* is operated to serve a public rather than a private interest. Control of the hospital rests with its board of trustees, which is composed of independent civic leaders. The hospital maintains an open medical staff, with privileges available to all qualified physicians. Members of its active medical staff have the privilege of leasing available space in its medical building. (See Rev. Rul. 69–464, page 132, this Bulletin.) It operates an active and generally accessible emergency room. These factors indicate that the use and control of Hospital *A* are for the benefit of the public and that no part of the income of the organization is inuring to the benefit of any private individual nor is any private interest being served.

Accordingly, it is held that Hospital *A* is exempt from Federal income tax under section 501(c)(3) of the Code.

Hospital *B* is also providing hospital care. However, in order to qualify under section 501(c)(3) of the Code, an organization must be organized and operated *exclusively* for one or more of the purposes set forth in that section. Hospital *B* was initially established as a proprietary institution operated for the benefit of its owners. Although its ownership has been transferred to a nonprofit organization, the hospital has continued to operate for the private benefit of its original owners who exercise control over the hospital through the board of trustees and the medical committee. They have used their control to restrict the number of doctors admitted to the medical staff, to enter into favorable rental agreements with the hospital, and to limit emergency room care and hospital admission substantially to their own patients. These facts indicate that the hospital is operated for the private benefit of its original owners, rather than for the exclusive benefit of the public. See *Sonora Community Hospital* v. *Commissioner,* 46 T.C. 519 (1966), aff'd. 397 F. 2d 814 (1968).

Accordingly, it is held that Hospital *B* does not qualify for exemption from Federal income tax under section 501(c)(3) of the Code. In considering whether a nonprofit hospital claiming such exemption is operated to serve a private benefit, the Service will weigh all of the relevant facts and circumstances in each case. The absence of particular factors set forth above or the presence of other factors will not necessarily be determinative.

Even though an organization considers itself within the scope of *Situation* 1 of this Revenue Ruling, it must file an application on Form 1023, Exemption Application, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. The application should be filed with the District Director of Internal Revenue for the 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.

Revenue Ruling 56–185, C.B. 1956–1, 202, sets forth requirements for exemption of hospitals under section 501(c)(3) more restrictive than those contained in this Revenue Ruling with respect to caring for patients without charge or at rates below cost. In addition, the fourth requirement of Revenue Ruling 56–185 is ambiguous in that it can be read as implying that the possibility of "shareholders" or "members" sharing in the assets of a hospital upon its dissolution will not preclude exemption of the hospital as a charity described in section 501(c)(3) of the Code. Section 1.501(c)(3)–1(b)(4) of the regulations promulgated subsequent to Revenue Ruling 56–185 makes it clear, however, that an absolute dedication of assets to charity is a precondition to exemption under section 501(c)(3) of the Code.

Revenue Ruling 56–185 is hereby modified to remove therefrom the requirements relating to caring for patients without charge or at rates below cost. Furthermore, requirement four has been modified by section 1.501(c)(3)–1(b)(4) of the regulations.

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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.

A nonprofit organization, created to construct and maintain a building for the exclusive purpose of housing and serving exempt member agencies of a community chest, may be exempt under section 501(c)(3) of the Code; Revenue Ruling 58–547 distinguished.

Rev. Rul. 69–572

Advice has been requested whether a nonprofit organization formed and operated in the manner 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 to construct and maintain a building to house member agencies of a community chest, thereby facilitating coordination among the agencies and making more efficient use of the available voluntary labor force. Membership in the organization is limited to the board of directors of the community chest. The agencies occupying the building are exempt from Federal income tax under section 501(c)(3) of the Code. The building's construction expenses were financed by contributions from the general public and by the issuance of noninterest bearing obligations to other charitable organizations.

The organization's building was erected on city land that is the subject of a long-term lease under which the organization pays only a nominal rental and is committed to use the premises for the exclusive purpose of housing and otherwise serving the community chest agencies.

Office space in the building is leased to member agencies at a rate that makes the organization's rental income approximately equal to its total annual operating costs without any allowance for depreciation. This results in a rental rate that is substantially less than commercial rates for comparable facilities. The building also contains a large central meeting room that is separately maintained for the free use of the lessees and other interested community chest agencies under the general supervision and control of the organization's executive director.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for charitable purposes.

The organization has demonstrated that its operations will materially aid its various tenants and other users of its facilities in the performance of their respective charitable functions. All tenants receive a direct financial benefit in that the rental charges made are substantially less than the general commercial rate for comparable facilities. Moreover, the organization's provision for housing a number of member agencies at one convenient central place enables such agencies to make frequent use of volunteer labor on an efficient basis and promotes their common interests by facilitating the effective coordination of their interrelated operations and services.

The performance of a particular activity that is not inherently charitable may nonetheless further a charitable purpose. The overall result in any given case is dependent on why and how that activity is actually being conducted. See Rev. Rul. 67–4, C.B. 1967–1, 121. Because of the close connection between this organization and the charitable functions of the tenant-organizations, the rental of the organization's facilities at rates substantially below their fair rental value, and the operation by the organization with the intention of realizing an amount sufficient only to meet annual operating costs, the organization is dedicated to carrying out the charitable endeavors of the community chest and its member agencies. Accordingly, it is held that the organization is exempt from Federal income tax under section 501(c)(3) of the Code.

This Revenue Ruling is distinguishable from Revenue Ruling 58–547, C.B. 1958–2, 275, which holds that a lease, the parties to which are both exempt under section 501(c)(3) of the Code and which otherwise constitutes a business lease within the meaning of section 514 of the Code, will not be considered as substantially related to the charitable purpose of the lessor solely because the lessee is likewise an exempt organization. By contrast, the instant organization leases space in a non-commercial manner at substantially below the "going-rate," and there is a close relationship between its purposes and functions and those of the tenant organizations.

Even though an organization considers itself within the scope of this Revenue Ruling, it must file an application on Form 1023, Exemption Application, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. The application should be filed with the District Director of Internal Revenue for the 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.

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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.

A nonprofit organization formed by a medical staff of an exempt hospital to carry on a charitable program of benefit to the hospital qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 69–631

Advice has been requested whether a nonprofit organization organized and operated in the manner described below qualifies for exemption from Federal income tax under section 501(c)

(3) of the Internal Revenue Code of 1954.

The organization was formed by the active medical staff of a hospital exempt from Federal income tax under section 501(c)(3) of the Code. The purpose of the organization is to carry on a charitable program of benefit to the hospital. In furtherance of this purpose the organization provides scholarships and similar financial assistance to interns and residents during the course of their medical training, purchases new equipment for the hospital, and establishes various research grants.

The active medical staff consists of individuals engaged in the private practice of medicine who agree to undertake certain duties in connection with the hospital's operation. One of these duties is to provide medical services to patients admitted to the hospital without a personal physician. Before the enactment of Medicare and Medicaid legislation, many of these services were usually rendered without compensation. However, under the provisions of this legislation, most of these patients are now eligible for payments for medical services furnished to them. Instead of collecting the fees for the services rendered to these patients, the staff physicians, who are the members of the organization, assign to the organization their rights to receive these fees. The organization collects the fees and uses the proceeds to carry on its charitable program. The physicians render the medical services referred to as part of their duties as active staff members of the hospital. Such services are, therefore, not part of the organization's activities.

No part of the organization's funds is used for the private benefit of the members.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(d)(ii) of the Income Tax Regulations provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest.

Under the circumstances set forth above, the collection of the fees is merely the conversion of assigned assets to cash. The organization is carrying on a charitable program by providing funds for medical education, improvement of hospital facilities, and research. Since all funds are used for these purposes, the organization serves a public interest, rather than the private interest of any of the members. Accordingly, the organization is exempt from Federal income tax under section 501(c)(3) of the Code.

For a discussion of the tax treatment of the fees collected with respect to the physicians, see Rev. Rul. 58–220, C.B. 1958–1, 26, Rev. Rul. 66–377, C.B. 1966–2, 21, Rev. Rul. 69–274, C.B. 1969–1, 36, and Rev. Rul. 69–275, C.B. 1969–1, 36.

Even though an organization considers itself within the scope of this Revenue Ruling, it must file an application on Form 1023, Exemption Application, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. The application should be filed with the District Director of Internal Revenue for the 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.

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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. (Also 1.501(c)(6)–1.)

A nonprofit organization composed of members of a particular industry to develop new and improved uses for existing products of the industry is not exempt under section 501(c)(3) of the Code but may qualify for exemption under section 501(c)(6).

Rev. Rul. 69–632

Advice has been requested whether an association organized and operated as described below qualifies for exemption from Federal income tax under either section 501(c)(3) or section 501(c)(6) of the Code.

The nonprofit association composed of members of a particular industry was formed to develop new and improved uses for existing products of the industry. The association's income is from membership dues and assessments.

The association itself conducts no scientific research. It contracts with various research organizations, institutes, and universities for specific research projects selected by a committee of technical experts chosen from the association's membership. The results of these projects are published and made available to the interested public.

Patents and trademarks that may result from research projects sponsored by the association are licensed royalty-free to all applicants meeting the quality standards set by the association.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for scientific purposes.

Section 1.501(c)(3)–1(d)(1)(ii) of the Income Tax Regulations provides that an organization is not organized or operated exclusively for any purpose set forth in section 501(c)(3) of the Code unless it serves a public rather than a private interest.

Section 1.501(c)(3)–1(d)(5) of the regulations provides that the term "scientific" as used in section 501(c)(3) of the Code includes the carrying on of scientific research in the public interest. For research to be scientific within the meaning of section 501(c)(3), it must be carried on in furtherance of a scientific purpose.

Section 1.501(c)(3)–1(d)(5)(iv) of the regulations provides that an organization will not be regarded as organized and operated for the purpose of carrying on scientific research in the public interest and will not qualify for exemption under section 501(c)(3) of the Code as a scientific organization if that organization will perform research only for persons which are (directly or

indirectly) its creators and which are not described in section 501(c)(3).

The association's research projects may result in new products and processes that benefit the public, but such benefit is secondary to that derived by the association's members. The association's members select research projects in order to increase their sales by creating new uses and markets for their product. Therefore, it is held that the primary purpose of the association's research is to serve the private interests of its creators, rather than the public interest. Accordingly, the association does not qualify for exemption from Federal income tax under section 501(c)(3) of the Code.

Section 501(c)(6) of the Code provides for the exemption from Federal income tax of business leagues, not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(6)-1 of the regulations requires that in order to qualify for exemption under section 501(c)(6) an organization's activities should be directed to the improvement of business conditions in one or more lines of business as distinguished from the performance of particular services for individual persons.

No services are performed by this association for any individual member, nor are any of the association's patents and trademarks licensed to any member on an exclusive basis. Since the association's activities are directed towards improving the business conditions of the industry, in general, it is held that the organization is exempt from Federal income tax under section 501(c)(6) of the Code.

Even though an organization considers itself within the scope of the Revenue Ruling, it must file an application on Form 1024, Exemption Application, in order to be recognized by the Service as exempt under section 501(c)(6) of the Code. The application should be filed with the District Director of Internal Revenue for the 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.

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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. (Also Section 513; 1.513-1.)

Answers to questions involving the tax exempt status of (1) hospitals that establish a cooperative hospital laundry service; and (2) a hospital which establishes its own laundry facilities and sells service to other hospitals.

Rev. Rul. 69–633

The Internal Revenue Service has been asked a series of questions pertaining to the tax consequences of operating laundry services for hospitals. The questions and the answers are set forth below.

Section 501(c)(3) of the Internal Revenue Code of 1954 provides for the exemption from Federal income tax of organizations organized and operated exclusively for charitable, scientific, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 501(e) of the Code provides for exemption from Federal income tax of certain hospital service organizations organized and operated solely to perform specified services for member hospitals. Section 501(e)(1)(A) of the Code lists the specified services as data processing, purchasing, warehousing, billing and collection, food, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training, and education of personnel) services.

Section 513 of the Code defines the term "unrelated trade or business," in the case of any organization subject to the tax imposed by section 511, 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 the purposes or function constituting the basis for its exemption under section 501.

Situation 1: A number of hospitals exempt from Federal income tax under section 501(c)(3) of the Code formed a laundry service organization. The organization was organized and operated on a cooperative basis to serve only the hospitals that organized it. All net earnings are required to be allocated or paid to patrons on the basis of services performed for them.

Question 1: Can the organization qualify for exemption from Federal income tax as a cooperative hospital service organization under section 501(c)(3) of the Code by reason of section 501(e)?

Answer: In order to qualify as a cooperative hospital service organization under the provisions of section 501(e) of the Code, an organization must be organized and operated solely to perform one or more of the services specified in section 501(e)(1)(A) of the Code. Since laundry services are not one of the services specified in that section, the organization does not meet the requirements of section 501(e) of the Code, and thus is not exempt from Federal income tax under section 501(c)(3). See Rev. Rul. 69–160, C.B. 1969–1, 147. However, if all of the organization's net earnings derived from dealings with patrons are distributed or allocated pursuant to a preexisting obligation to the patron hospitals within the time and manner prescribed for cooperative organizations in section 1381–83 of the Code, the organization would have no taxable income from such dealings.

Question 2: Would contributions by the member hospitals or other organizations exempt from Federal income tax under section 501(c)(3) of the Code to this laundry service organization affect the tax exempt status of the contributing organizations?

Answer: The service organization is entirely under the control of, and holds its property for the use of, hospitals

that are exempt from Federal income tax under section 501(c)(3) of the Code. All funds contributed to the organization are therefore applied exclusively for the use of organizations exempt under section 501(c)(3) of the Code. For this reason, contributions to the laundry service organization by exempt organizations will not jeopardize the exemption of the contributing organizations. See Rev. Rul. 68–489, C.B. 1968–2, 210.

Question 3: Would the answer to *question 2* be the same if a proprietary hospital, operated for profit, became a member of the service organization?

Answer: Although a hospital exempt under section 501(c)(3) of the Code could belong to a cooperative laundry service organization having nonexempt members without affecting its exempt status, its exemption might be adversely affected if the exempt hospital also made contributions to the laundry in excess of its proportionate share based on benefits to be derived. Any contributions made by the exempt hospital under these circumstances might inure to the benefit of the proprietary hospital and therefore would not be an expenditure in furtherance of an exempt purpose. Similarly, a contribution by any other exempt organization might also inure to the benefit of the proprietary hospital and adversely affect the contributing organization's exempt status.

Situation 2: A hospital exempt from Federal income tax under section 501(c)(3) of the Code established its own laundry facility. However, in addition to providing for its own laundry services, the hospital also provides laundry services to other hospitals that are also exempt under section 501(c)(3) of the Code.

Question 1: Does the sale of laundry services to other exempt hospitals affect the hospital's exempt status under section 501(c)(3) of the Code or the exempt status of organizations making contributions to the hospital?

Answer: The sale of laundry services to other hospitals is not an activity substantially related to the performance of the selling hospital's exempt purposes. Therefore, such activity would be unrelated trade or business within the meaning of section 513 of the Code and any profits derived would be subject to the unrelated business income tax imposed by section 511. However, the exempt status of the operating hospital or the contributing organizations would not be affected.

Question 2: If the hospital provided laundry services to a proprietary hospital, would its exemption be affected?

Answer: If the hospital provided services to a proprietary hospital above cost, such activity would have no effect upon its exemption or that of its contributors. However, if it provided laundry services to proprietary hospitals at less than cost, its exempt status might be affected because such services would not be in furtherance of an exempt purpose.

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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.

Whether a lease by a hospital to a hospital-based group practice of office space and services is unrelated trade or business. See Rev. Rul. 69–463, page 131.

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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.

Whether leases of office space by a hospital to members of its medical staff are considered business leases. See Rev. Rul. 69–464, page 132.

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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.

Exemption of a college fraternity from Federal income tax. See Rev. Rul. 69–573, page 125.

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26 CFR 1.501(c)(4)–1: Civic organizations and local associations of employees.

An organization created to maintain an amateur baseball association made up of baseball teams with amateur players of college age is exempt under section 501(c)(4) of the Code.

Rev. Rul. 69–384

Advice has been requested whether a nonprofit organization created for the primary purpose of maintaining an amateur baseball association and conducting amateur baseball games among its member teams is exempt from Federal income tax under section 501(c)(4) of the Internal Revenue Code of 1954.

The organization was formed to unite those interested in advancing amateur baseball for young men of college age, and to develop a program of sportsmanship, character-building, citizenship, and physical and mental well-being.

The organization establishes summer baseball schedules and sets standards, policies, and ethics that govern the member teams in a particular community. Its operating funds are obtained through league fees, forfeit fees, and tournament fees paid to it by the various member teams. The funds are used to purchase trophies and to pay umpires, ballboys, insurance, and other necessary costs. The players do not receive any pay or share in the funds of the organization.

Section 501(c)(4) of the Code provides for the exemption from Federal income tax of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)–1(a)(2) of the Income Tax Regulations provides 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 that is operated primarily for the purpose of bringing about civic betterments and social improvements.

By helping to develop good sportsmanship, high character, and the physical and mental well-being of young adults through the operation of

an amateur baseball league, it is held that the organization is promoting the common good and general welfare of the people of the community. Accordingly, this organization is exempt from Federal income tax under section 501 (c) (4) of the Code. Compare Revenue Ruling 55–516, C.B. 1955–2, 260, which holds that a semiprofessional baseball club is not exempt under section 501 (c) (4) of the Code.

Even though an organization considers itself within the scope of this Revenue Ruling, it must (in order to establish exemption under section 501 (c) (4) of the Code) file 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.

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26 CFR 1.501(c)(4)–1: Civic organizations and local associations of employees.

A community welfare corporation that purchases and sells unimproved land and engages in other business activities, the profits from which are distributed to members, is not exempt under section 501(c)(4) of the Code.

Rev. Rul. 69–385

Advice has been requested whether the corporation described below qualifies for exemption from Federal income tax as a social welfare organization under section 501 (c) (4) of the Internal Revenue Code of 1954.

The corporation was formed for the stated purpose of promoting the general welfare of the residents of a particular community. Membership in the corporation was available to those who owned property in a designated area. They paid an assessement based on the amount of property owned. Membership is transferable to successive purchasers of property owned by the original members.

The corporate bylaws provide that any profits of the corporation shall be apportioned pro rata among the members according to the assessment originally paid.

The corportaion used the original assessments to purchase unimproved lots and some undeveloped land in the area. Over the years, the corporation sold on a sporadic basis some of the property and received substantial income from such sales. It derived additional income from the investment of the proceeds from the sales. The corporation improved and maintained nonresidential property and engaged in other activities for the benefit of all the residents of the area. On several occasions the corporation distributed profits to the members in accordance with its bylaws provisions.

Section 501 (c) (4) of the Code provides for the exemption of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501 (c) (4)–1 (a) (1) of the Income Tax Regulations states that an organization may be exempt under section 501 (c) (4) of the Code if it is not organized or operated for profit and it is operated exclusively for the promotion of social welfare.

The corporation is authorized to make, and in fact made, distributions of profits to its members. These distributions are equivalent to dividends based upon equity ownership and result in profit to the members. It is held that the corporation does not qualify for exemption from Federal income tax under section 501 (c) (4) of the Code since the authority for making the distributions and the distributions themselves are incompatible with the requirements of the regulations that an organization must not be organized or operated for profit.

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26 CFR 1.501(c)(5)–1: Labor, agricultural, and horticultural organizations. (Also Section 502; 1.502–1.)

A company, even though formed to provide employment to members of a certain labor union to which the company pays all of the profits from its business operation, is not exempt under section 501(c)(5) of the Code; O.D. 523 superseded.

Rev. Rul. 69–386 [1]

The purpose of this Revenue Ruling is to update and restate under the current statute and regulations the position set forth in O.D. 523, C.B. 2, 211 (1920). The question is whether the organization described below qualifies for exemption under section 501 (c) (5) of the Internal Revenue Code of 1954.

A company was organized to provide employment to members of a certain labor union exempt from Federal income tax under section 501 (c) (5) of the Code. It operates a business as its only activity and is owned and controlled by the union to which it turns over all of its profits.

Section 501 (c) (5) of the Code provides for exemption from Federal income tax of labor organizations.

Section 502 of the Code provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.

The term "labor organization" is used in section 501 (c) (5) of the Code in its commonly accepted sense. It refers to organizations such as labor unions, labor councils, and committees. See *Portland Co-operative Labor Temple Association* v. *Commissioner,* 39 B.T.A. 450 (1939), acquiescence, C.B. 1939–1 (Part 1), 28.

A business formed to employ union members is not a labor organization in its commonly accepted sense and therefore is not exempt from Federal income tax under section 501 (c) (5) of the Code. Furthermore, by reason of section 502 of the Code, the company is not exempt on the grounds that the profits from its business activities are paid over to the labor union, which is exempt under section 501.

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[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

O.D. 523 is superseded since the position set forth therein is restated under current law in this Revenue Ruling.

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26 CFR 1.501(c)(6)–1: Business leagues, chambers of commerce, real estate boards, and boards of trade.

A nonprofit organization composed of advertising agencies, which verifies the advertising claims of publications selling advertising space and makes reports available to members of the advertising industry generally, qualifies for exemption under section 501(c)(6) of the Code.

Rev. Rul. 69–387

Advice has been requested whether the nonprofit organization described below qualifies for exemption from Federal income tax under section 501 (c) (6) of the Internal Revenue Code of 1954.

The organization is composed of advertising agencies placing advertising in newspapers and magazines. The publications make representations concerning the size of circulation and the economic background of their subscribers. An agency planning an effective promotion places advertising in reliance on these representations.

The organization's sole activity consists of the verification of these representations. It conducts periodic audits of each publication and reports on the accuracy of the publications' claims. The reports are made available to members of the advertising industry generally.

Section 501(c)(6) of the Code provides for the exemption from Federal income tax of business leagues not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(6)–1 of the Income Tax Regulations defines a business league as an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.

Confirming the quality of products or services available to an industry promotes the common business interest of its members. It is held that the organization in this case is promoting the common business interest of the advertising industry as a whole by conducting audits to determine the quality of services available to the industry and making the results available to the industry generally.

Accordingly, the organization qualifies for exemption from Federal income tax under section 501(c)(6) of the Code.

Even though an organization considers itself within the scope of this Revenue Ruling, it must (in order to establish exemption under section 501(c)(6) of the Code) file an application 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.

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26 CFR 1.501(c)(6)–1: Business leagues, chambers of commerce, real estate boards, and boards of trade.

An organization formed to improve the business conditions of financial institutions by offering rewards for information leading to the arrest and conviction of individuals committing crimes against its members qualifies for exemption under section 501(c)(6) of the Code.

Rev. Rul. 69–634

Advice has been requested whether an association of financial institutions operated as described below is exempt from Federal income tax under section 501(c)(6) of the Internal Revenue Code of 1954.

The association was formed to improve the business conditions of financial institutions in a particular area. As its sole activity, the association offers rewards for information leading to the arrest and conviction of individuals committing crimes against its member institutions. The rewards are publicized without mention of the names of the members. A majority of the financial institutions in the area are members of the association and membership is open to the remaining institutions. The organization is funded by annual assessments of the participating institutions.

Section 501(c)(6) of the Code provides for the exemption from Federal income tax of business leagues not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(6)–1 of the Income Tax Regulations defines a business league as an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.

Offering rewards for information leading to the arrest and conviction of persons committing crimes against members stimulates public interest and assistance in solving such crimes, thereby operating as a deterrent to future criminal acts. Therefore, the primary purpose of the association is to improve the business conditions of financial institutions generally by reducing robberies and other criminal acts, rather than to assist in apprehending an individual who has committed a criminal act against a particular member institution. Any benefit to a particular institution is merely one of the results that

flow from the effort to improve conditions in the industry generally.

The association's activities are directed to the improvement of business conditions in one or more lines of business as distinguished from the performance of particular services for individual persons. Accordingly, it is held that the association qualifies for exemption from Federal income tax under section 501(c)(6) of the Code.

Even though an organization considers itself within the scope of this Revenue Ruling, it must file an application on Form 1024, Exemption Application, in order to be recognized by the Service as exempt under section 501(c)(6) of the Code. The application should be filed with the District Director of Internal Revenue for the 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.

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26 CFR 1.501(c)(6)–1: Business leagues, chambers of commerce, real estate boards, and boards of trade.

A nonprofit association composed of members of a particular industry to develop new and improved uses for existing products of the industry. See Rev. Rul. 69–632, page 120.

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26 CFR 1.501(c)(7)–1: Social clubs.

A social club formed to assist its members in their business endeavors through study and discussion of problems and other activities at weekly luncheon meetings does not qualify for exemption under section 501(c)(7) of the Code.

Rev. Rul. 69–527

Advice has been requested whether a nonprofit organization formed and operated as described below qualifies for exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954.

The organization was formed and has been operated to study and discuss business and financial problems; to interchange among its membership business and financial information in order to create and encourage efficiency in business and finance; to assist its members in the expansion and development of their individual trades, businesses, and professions by encouraging the direct interchange of patronage among members; and to assist its members in extending and establishing new trade, business, and professional contacts. Membership is limited to one member from any particular trade or profession. The activities of the organization are carried on at weekly luncheon meetings.

Section 501(c)(7) of the Code provides for exemption from Federal income tax of clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes provided no part of the net earnings inures to the benefit of any private shareholder.

To qualify for exemption under section 501(c)(7) of the Code, an organization must be both organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes. Consequently, not only must an organization show that its members are bound together by a common objective, but that such common objective is directed towards pleasure, recreation, and other nonprofitable purposes. The term "other nonprofitable purposes" has been held to mean other purposes similar to pleasure and recreation. See *Keystone Automobile Club* v. *Commissioner,* 181 F. 2d 402 (1950), and *Allied Trades Club, Inc.* v. *Commissioner,* 228 F. 2d 906 (1956).

Based on the facts set forth above, the organization is organized and operated primarily to aid its members in their individual business endeavors. Any social activities at the luncheon meetings are merely incidental to the business activities of the organization. Thus, it is not organized and operated exclusively to serve the pleasure, recreation, or other similar social purposes of its members. Accordingly, it is held that the organization is not exempt from Federal income tax under section 501(c)(7) of the Code.

See also Revenue Ruling 59–391, C.B. 1959–2, 151, which holds that such an organization does not qualify for exemption from Federal income tax under section 501(c)(6) of the Code.

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26 CFR 1.501(c)(7)–1: Social clubs.
(Also 1.501(c)(3)–1.)
(Also Section 170; 1.170–1.)

A college fraternity that maintains a chapter house for active members who are students of the school is not exempt under section 501(c)(3) of the Code but is exempt under section 501(c)(7); contributions to the fraternity are not deductible; I.T. 1427 and G.C.M. 5952 superseded.

Rev. Rul. 69–573 [1]

The purpose of this Revenue Ruling is to update and restate under the current statute and regulations the positions set forth in I.T. 1427, C.B. I–2, 187 (1922), and G.C.M. 5952, C.B. VIII–1, 172 (1929). The questions presented concern the exemption from Federal income tax under section 501 of the Internal Revenue Code of 1954 of the college fraternity described herein, and the deductibility of contributions to the fraternity under section 170 of the Code.

The fraternity is an organization of students and alumni, with those currently attending school comprising its active membership. New members are chosen in their freshman or sophomore years by the active members. The basis for selection is largely one of companionability, although some academic qualifications also exist. The fraternity owns a chapter house, which was built with the proceeds from contributions from its members, and which contains living rooms, dining rooms, sleeping rooms, study rooms, and a library. The chapter house also serves as a center for the social activities of its members. The fraternity is not operated as an integral part of the college nor does the college exercise any direct control over its membership. The fraternity is organized on a nonprofit basis. All re-

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

ceipts from members are used to pay the expenses of the chapter house and no part of its net income inures to the benefit of private individuals.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of an organization organized and operated exclusively for educational purposes.

Section 1.501(c)(3)–1(d)(2) of the Income Tax Regulations provides that the term "charitable" as used in section 501(c)(3) of the Code includes the advancement of education. Section 1.501(c)(3)–1(d)(3) of the regulations provides that the term "educational" relates to the instruction or training of the individual for the purpose of improving or developing his capabilities.

Section 501(c)(7) of the Code provides for the exemption from Federal income tax of clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes. Revenue Ruling 58–589, C.B. 1958–2, 266, describes the characteristics of a social club as personal contacts, fellowship, and a commingling of members.

Although the typical college fraternity does in some degree contribute to the cultural and educational growth of its members during their student years, this is not its primary purpose. *Phinney* v. *Dougherty,* 307 F. 2d 357 (1962); *Davison* v. *Commissioner,* 60 F. 2d 50 (1932), and the cases cited therein. Such an organization is primarily a social club in that its major functions are to provide a meeting place for its members, living quarters for many of them, the place where their meals are served, and the headquarters for their entertainment.

Accordingly, it is held that the organization is not exempt from Federal income tax under section 501(c)(3) of the Code but is exempt under section 501(c)(7). In view of the fact that this fraternity is not organized and operated exclusively for any of the purposes described in section 170(c) of the Code, it follows that contributions thereto are not deductible under section 170(a) of the Code.

Even though an organization considers itself within the scope of this Revenue Ruling, it must file an application on Form 1025, Exemption Application, in order to be recognized by the Service as exempt under section 501(c)(7) of the Code. The application should be filed with the District Director of Internal Revenue for the 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.

I.T. 1427 and G.C.M. 5952 are superseded since the positions set forth therein are restated under current law in this Revenue Ruling.

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26 CFR 1.501(c)(7)–1: Social clubs.

An automobile club whose principal activity is rendering automobile services to its members but has no significant social activities does not qualify for exemption under section 501(c)(7) of the Code; G.C.M. 23688 superseded.

Rev. Rul. 69–635 [1]

The purpose of this Revenue Ruling is to update and restate under the current statute and regulations the portion of G.C.M. 23688, C.B. 1943, 283, relating to whether the organization described is, in the light of its activities, organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes within the meaning of section 501(c)(7) of the Internal Revenue Code of 1954. The portion of G.C.M. 23688 relating to the definition of "clubs" as that term is used in section 501(c)(7) of the Code is covered in Revenue Ruling 67–428, C.B. 1967–2, 204.

The purpose of the organization is to promote highway safety and to provide various motoring conveniences to its members. Arrangements exist with numerous garages across the country whereby emergency repairs and road services are furnished to members and paid for by the organization. If a member's car is stolen, the organization will offer a reward for its recovery. If a member is arrested or detained for a traffic violation, the organization will post bond on his behalf. Personal travel information is supplied to members. Arrangements have been made to permit members to purchase automobile insurance at reduced premiums. Arrangements have also been made with merchants to allow members to buy clothing, laundry, furniture, and automobile supplies at discount prices. The organization does not carry on any significant social activities.

Section 501(c)(7) of the Code provides for exemption from Federal income tax for clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes.

The principal activity of this organization is the rendering of automobile services to its members. Most of the services offered are of a type generally available to motorists on a commercial basis. The rendition of such services is not in the nature of pleasure or recreation within the meaning of the statute. See *Keystone Automobile Club* v. *Commissioner,* 181 Fed. 2d 402 (1950), and *Chattanooga Automobile Club* v. *Commissioner,* 182 Fed. 2d 551 (1950).

Furthermore, in order to qualify for exemption under section 501(c)(7) of the Code, a commingling of members must play a material part in the activities of the organization. See Rev. Rul. 58–589, C.B. 1958–2, 266.

Because the principal activity of this organization is rendering automobile services to its members and there is no significant commingling of its members, this organization does not qualify for exemption from Federal income tax under section 501(c)(7) of the Code.

G.C.M. 23688 is superseded since the outstanding portion thereof is restated under current law in this Revenue Ruling.

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26 CFR 1.501(c)(7)–1: Social clubs.

The exempt status of a country club will not be adversely affected

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

if it makes its facilities available to an exempt organization for charitable fund-raising activities at a charge equal to or less than direct cost.

Rev. Rul. 69–636

A club exempt from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954 has asked whether its exempt status would be adversely affected if it rents its facilities under the circumstances described below.

The club was organized to operate and maintain a country club for the pleasure and recreation of its members. The club has been asked to permit an organization exempt from Federal income tax under section 501(a) of the Code to use its facilities to raise funds for charity. The sponsoring organization will sell admission tickets to the general public. Any profits will be donated by the sponsoring organization to an organization exempt under section 501(c)(3) of the Code.

The club's charges to the sponsoring organization will be set at or below cost. "Cost" for this purpose will be direct cost only and will not include any pro rata share of overhead expenses or depreciation. These charges will not reimburse the club for any portion of the expenses normally incurred in running the club for its members.

Section 501(c)(7) of the Code provides for the exemption from Federal income tax 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.

Section 1.501(c)(7)–1 of the Income Tax Regulations provides that, in general, exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments. However, a club which engages in business, such as making its social and recreational facilities available to the general public, is not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, and is not exempt under section 501(a).

Making its social and recreational facilities available to the sponsoring exempt organization for the purpose of raising funds for charity does not evidence a business activity within the meaning of the regulations because no possibility of profit exists since the charges will be set at a rate equal to or less than direct cost. Moreover, this activity will not result in inurement to the club or its members.

Accordingly, it is held that the use of the club facilities under the foregoing circumstances will not adversely affect the club's exemption from Federal income tax under section 501(c)(7) of the Code.

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26 CFR 1.501(c)(13)–1: Cemetery companies.

The exemption of a cemetery company is adversely affected by engaging in the operation of a crematorium.

Rev. Rul. 69–637

Advice has been requested whether the status of a cemetery company exempt from Federal income tax under section 501(c)(13) of the Internal Revenue Code of 1954 is adversely affected where it establishes and operates a crematorium in the manner described below.

The organization was formed and operated for the purpose of providing and maintaining a cemetery. Its articles of incorporation were subsequently amended to enable it also to maintain and operate a crematorium, and it has operated in accordance with this amendment.

Section 501(c)(13) of the Code provides for the exemption from Federal income tax of cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit; and any corporation chartered solely for burial purposes as a cemetery corporation *and not permitted by its charter to engage in any business not necessarily incident to that purpose,* no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Under these provisions, an organization claiming exemption under section 501(c)(13) of the Code may not engage in activities that are not necessary incidents to its burial purposes. To be a necessary incident to burial, an activity must be related to the procuring, sale, holding, and use of land solely as a burial ground. See Rev. Rul. 64–109, C.B. 1964–1 (Part 1), 190. The operation of a crematorium is not necessary to the procuring, sale, holding, and use of land solely as a burial ground.

Accordingly, it is held that the cemetery's exemption from Federal income under section 501(c)(13) of the Code is adversely affected by engaging in the operation of the crematorium.

Section 502.—Feeder Organizations

26 CFR 1.502–1: Feeder organizations.

An organization regularly carrying on an investment service business that would be unrelated trade or business if carried on by any of the exempt organizations on whose behalf it operates, is not exempt under section 501(a) of the Code.

Rev. Rul. 69–528

Advice has been requested whether the organization described below qualifies for exemption from Federal income tax under section 501(a) of the Internal Revenue Code of 1954 as an organization described in either section 501(c)(2) or section 501(c)(3) of the Code.

The organization was formed to provide investment services on a fee basis exclusively to organizations exempt from Federal income tax under section 501(c)(3) of the Code. It receives funds from the participating exempt organizations, invests in common stocks, reinvests income and realized appreciation, and upon request liqui-

dates a participant's interest and distributes the proceeds to the participant.

The organization is free from the control of the participants and has the absolute and uncontrolled discretion in (1) investment of the property, (2) sale of investments and reinvestment of the proceeds, (3) payment of taxes and liens, (4) distributions of income and principal or the addition of accumulated income to principal, and (5) dealing with the property and managing the funds as if it were absolute owner thereof. In addition, a participant's ownership interest in the property does not entitle such participant to the whole or any part of the property or the right to call for a partition, division, or accounting of the property.

Section 502 of the Code provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under section 501 on the ground that all of its profits are payable to one or more organizations exempt from Federal income tax under section 501.

Section 1.502–1(b) of the Income Tax Regulations provides that a subsidiary organization of an exempt organization is not exempt from tax if it is operated for the primary purpose of carrying on a trade or business which would be an unrelated trade or business (that is, unrelated to exempt activities) if regularly carried on by the parent organization. For example, if a subsidiary organization is operated primarily for the purpose of furnishing electric power to consumers other than its parent organization (and the parent's tax-exempt subsidiary organizations), it is not exempt since such business would be an unrelated trade or business if regularly carried on by the parent organization. Similarly, if the organization is owned by several unrelated exempt organizations, and is operated for the purpose of furnishing electric power to each of them, it is not exempt since such business would be an unrelated trade or business if regularly carried on by any one of the tax-exempt organizations.

Providing investment services on a regular basis for a fee is trade or business ordinarily carried on for profit. If the services were regularly provided by one tax-exempt organization for other tax-exempt organizations, such activity would constitute unrelated trade or business. Based upon the above-cited statute and regulations, it is held that this organization is not exempt under section 501(a) of the Code as an organization described in either section 501(c)(2) or section 501(c)(3) since it is regularly carrying on the business of providing investment services that would be unrelated trade or business if carried on by any of the tax-exempt organizations on whose behalf it operates.

Compare Revenue Ruling 56–267, C.B. 1956–1, 206, which holds that where, under certain specified conditions, exempt employees' trusts pool their funds in a group trust to provide diversification of investment, the group trust may qualify as an exempt employees' trust and the exempt status of the separate trusts will not be adversely affected. That Revenue Ruling specifies that in order to meet the qualification requirements under section 401(a) of the Code, the group trust must itself be adopted as a part of each employer's pension or profit-sharing plan, and that the group trust instrument must prohibit that part of its corpus or income which equitably belongs to any participating exempt employees' trust from being used for or diverted to any purpose other than for the exclusive benefit of the employees or their beneficiaries who are entitled to benefits under such participating trust. Under such conditions, one or more trusts may form part of a qualified plan, referred to in section 401(a), and maintain exemption under section 501(a).

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26 CFR 1.502–1: Feeder organizations.

Whether a company formed to furnish employment to union members turns over profits from its business to a labor union exempt under section 501(c)(5). See Rev. Rul. 69–386, page 123.

Section 503.—Requirements for Exemption

26 CFR 1.503(a)–1: Denial of exemption to organizations engaged in prohibited transactions.

Whether a nonprofit home for the aged is subject to the provisions of section 503 of the Code. See Rev. Rul. 69–401, below.

Section 504.—Denial of Exemption

26 CFR 1.504.1: Denial of exemption. (Also Section 503; 1.503(a)–1.)

Application of sections 503 and 504 of the Code with respect to activities of a home for the aged exempt under section 501(c)(3).

Rev. Rul. 69–401

A home for the aged exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 has presented a series of questions to the Internal Revenue Service with respect to the application of sections 503 and 504 of the Code to the activities described below.

The organization was founded in 1890 through public contributions. Over the years it has built up a substantial endowment fund. The fund produces enough income to enable the home to support those of its residents who are unable to pay the full cost of their care. The home does not charge an entrance fee nor make a monthly charge for its services. However, the organization requires that each resident assign to the home all his real and personal property, including his right to all pensions, annuities, and social security payments, but it does not make admission contingent upon an applicant's net worth and admits many persons who are totally indigent. Since the organization assumes the primary responsibility for the life care of its residents, it treats all of the assigned funds received as contributions to its endowment fund. The organization also receives payments from Federal, State, and local governments under various old age assistance and health programs for care and services provided to its residents.

The principal purpose of the home is to provide domiciliary and custodial care to 120 elderly residents. As part of its services it maintains a 15 bed infirmary for the treatment of minor illness.

Section 504 of the Code provides that in the case of any organization described in section 501(c)(3) of the Code to which section 503 is applicable, exemption under section 501 shall be denied for the taxable year if the amounts accumulated out of income during the taxable year or any prior taxable year and not actually paid out by the end of the taxable year are unreasonable in amount or duration in order to carry out the charitable, educational, or other purpose or function constituting the basis for such organization's exemption under section 501(c)(3).

Section 503(b)(3) of the Code excepts from the provisions of section 503 of the Code an organization that normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(a)) from the United States or any State or political subdivision thereof or from direct or indirect contributions from the general public.

Section 503(b)(5) of the Code excepts from the provisions of section 503 of the Code an organization the principal purposes or functions of which are the providing of medical or hospital care.

Question No. 1: Can the property and property rights assigned to the organization be treated as "contributions from the general public" within the meaning of section 503(b)(3) of the Code?

Answer: The assignment of all property and property rights is a condition precedent to admission to the home. Such assignments are made in consideration for the future care and services that the organization becomes obligated to render to the assignor. The assignments are therefore contractual payments rather than contributions within the meaning of section 503(b)(3) of the Code. See Rev. Rul. 58–303, C.B. 1958–1, 61. In addition, since the term "general public" used in section 503(b)(3) of the Code implies a class of persons broader than that directly benefiting from the activities of the donee organization, the residents of the home cannot be considered the "general public" within the meaning of section 503(b)(3).

Question No. 2: Since the organization treats assignments of property as contributions, are such assignments includible as income for purposes of determining the amount of accumulated income under section 504 of the Code?

Answer: Contributions, as such, are not considered "income" within the meaning of that term in section 504 of the Code and may therefore be disregarded for the purpose of determining whether amounts accumulated out of income are unreasonable. See Rev. Rul. 58–535, C.B. 1958–2, 270. However, as indicated in the answer to Question 1, assignments by residents constitute income to the organization, rather than contributions. Accordingly, such receipts must be included in determining whether amounts accumulated out of income are unreasonable within the meaning of section 504 of the Code.

Question No. 3: Do the payments received under Federal, state, and local government programs constitute support "from the United States or any State or political subdivision thereof" within the meaning of section 503(b)(3)?

Answer: Payments received under governmental programs for services rendered to residents are in the nature of fees paid for services and do not represent support from the United States or any State or political subdivision thereof within the meaning of section 503(b)(3) of the Code. See Rev. Rul. 67–397, C.B. 1967–2, 408.

Question No. 4: Does the organization come within the exception provided by section 503(b)(5) of the Code because of the medical care offered in its infirmary?

Answer: In order for an organization to come within the exception provided by section 503(b)(5) of the Code, providing medical or hospital care must be its principal purpose or function. The principal purpose of this organization is to provide elderly persons with lifetime domiciliary and custodial care. Nursing and medical services are furnished only incidentally to this purpose. Accordingly, the organization does not come within the exception provided by section 503(b)(5) of the Code. See section 1.170–2(b)(4)(i) of the Income Tax Regulations.

Question No. 5: Do the provisions of sections 503 and 504 of the Code apply to operating charitable organizations, such as the subject organization, or do they apply only to passive funding organizations?

Answer: Section 503(b) of the Code makes section 503 applicable to all organizations described in section 501(c)(3) of the Code except those organizations specifically described in sections 503(b)(1) through 503(b)(5). Since organizations, such as the subject organization, are exempt under section 501(c)(3) of the Code, they are subject to the provisions of sections 503 and 504 of the Code unless they meet one of the exceptions described in section 503(b) of the Code.

Part II. Taxation of Business Income of Certain Exempt Organizations

Section 512.—Unrelated Business Taxable Income

26 CFR 1.512 (a)–1: Definition.
(Also Section 513; 1.513–1.)

Income from the publication and sale of a book by an exempt organization is unrelated business income; however, if it transfers its publication rights to a commercial publisher, royalty income received is not unrelated business income.

Rev. Rul. 69–430

Advice has been requested whether, in the situation described below, in-

come derived by an organization subject to the provisions of section 511 of the Internal Revenue Code of 1954 constitutes unrelated business taxable income within the meaning of section 512 of the Code.

The organization, which is exempt from Federal income tax under section 501(a) of the Code, engages primarily in activities in furtherance of its exempt purposes. It also owns the publication rights to a book. The publication and distribution of the book will not contribute in any manner to the accomplishment of the exempt purposes of the organization except for the organization's need for the income to be derived therefrom.

The organization has undertaken to exploit the book in a commercial manner. It has arranged for the printing, distribution, and retail sale of the book. The organization has also arranged for appropriate publicity and advertising in connection with the distribution and sale of the book.

The specific question presented is whether the organization's activities relating to the book constitute the conduct of a trade or business regularly carried on within the meaning of section 512 of the Code.

Section 512 of the Code provides that unrelated business taxable income is the income derived by an organization from any unrelated trade or business regularly carried on by it. Section 512(b)(2) provides that income derived from royalties is to be excluded in computing unrelated business taxable income.

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 the income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its exempt purposes.

Section 1.513–1(d)(2) of the Income Tax Regulations provides that a trade or business is "substantially related" to exempt purposes when the business activity has a substantial causal relationship to the achievement of the exempt purposes. Thus, for the conduct of a trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes.

It is held that the organization's activities in connection with the publication, distribution, and sale of the book in the manner described constitute the conduct of a trade or business regularly carried on and that the income derived is unrelated business taxable income under section 512 of the Code.

However, had the organization transferred the publication rights to a commercial publisher in return for royalties, the royalty income derived would have been excluded from the computation of unrelated business taxable income under section 512(b)(2) of the Code.

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26 CFR 1.512(a)–1: Definition.
(Also Section 513; 1.513–1.)

The passive receipt of income by an exempt employees' trust from installment notes purchased from the employer-settlor is not unrelated business taxable income under section 512 of the Code.

Rev. Rul. 69–574

Advice has been requested whether income received by an exempt employees' trust under the circumstances described below is unrelated business taxable income within the meaning of section 512 of the Internal Revenue Code of 1954.

The employer that established the trust is engaged in the business of selling tractors and heavy equipment. When a sale is made on credit, the customer makes a cash down payment and signs an installment note for the unpaid balance. The note is secured by a chattel mortgage on the particular piece of equipment involved. By the terms of the conditional sales contract, title to the equipment remains in the employer. The unpaid balance due under the contract and the interest rate are stated in the note.

The employer sells some of the notes to its employees' trust, and others to banks or other financial institutions, for the exact unpaid balance stated in the note. The notes and contracts sold to the employees' trust are endorsed with full recourse and the employer handles all collections on the notes. In the event of a default on a note, the employer repurchases the paper from the trust or financial institution and collects the unpaid balance on its own behalf. The trust's activities with respect to the notes are merely to purchase the paper, receive periodic payments, and attend to the necessary bookkeeping functions.

Section 512(a) of the Code defines "unrelated business taxable income" as income derived by any organization from any unrelated trade or business regularly carried on by it.

Under section 513(b) of the Code, the term "unrelated trade or business" means, in the case of a trust described in section 401(a) of the Code which is exempt from Federal income tax under section 501(a), any trade or business regularly carried on by such trust.

Section 1.513–1(a)(1) of the Income Tax Regulations states that "trade or business" means the same for the purposes of section 513 of the Code as it does for purposes of section 162.

In the case of *Eugene Higgins* v. *Commissioner,* 312 U.S. 212 (1941), Ct. D. 1486, C.B. 1941–1, 339, the Supreme Court of the United States held, under section 23(a) of the Revenue Act of 1932 (a predecessor of section 162 of the 1954 Code), that a taxpayer was not engaged in a trade or business and thus not entitled to a business deduction with regard to certain transactions involving the purchase and sale of securities. The taxpayer bought and sold only for his own account. He sought permanent

investments, but changes, redemptions, maturities, and accumulations caused limited shiftings in his portfolio. The basis for the Court's holding was that the taxpayer's activities with respect to the investments were primarily passive in nature, in that he merely kept books and collected dividends and interest.

In the instant case, as in the *Higgins* case, the trust's receipt of income is also primarily of a passive nature. It merely keeps the records and receives the periodic payments of principal and interest collected for it by the employer.

Accordingly, it is held that the income received by the trust from the notes in this case is not unrelated business taxable income within the meaning of section 512 of the Code.

Section 513.—Unrelated Trade or Business

26 CFR 1.513–1: Definition of unrelated trade or business.
(Also Section 501; 1.501(c)(3)–1.)

The leasing of its adjacent office building, and the furnishing of certain office services, by an exempt hospital to a hospital-based medical group is not unrelated trade or business under section 513 of the Code.

Rev. Rul. 69–463

A community hospital exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 has asked whether the leasing arrangements described below constitute unrelated trade or business under section 513 of the Code.

The hospital has a medical staff of over 150 physicians and surgeons who have the privilege of admitting and treating patients in the hospital. However, in order to improve the hospital's ability to deliver a full range of health services to the community, the board of trustees decided to enter into negotiations with a medical group to induce them to carry on their professional activities on the hospital premises.

The medical group consists of 25 physicians and surgeons who, as their principal professional activity and as a group responsibility, are engaged in the coordinated practice of medicine in a common facility. The group is composed of a variety of medical specialists, including radiologists, pathologists, anesthesiologists, and internists.

As a result of arm's length negotiations, the hospital leased its adjacent office building to the group. The group uses the facility to provide medical services for its private patients. In addition, under the terms of the contract the various specialists within the group are also responsible for providing all diagnostic and therapeutic procedures, such as anesthesiology and radiology, to all hospital patients. The contract also requires that the group operate the hospital's emergency room on a 24-hour basis.

Because of its physical proximity to the hospital, the group is able to serve the outpatient needs of persons seeking medical services from the hospital on an ambulatory basis. In this way, the medical group also functions as the outpatient department of the hospital. The hospital maintains all medical records of the group as part of its central record keeping system.

Under the terms of the contract, the hospital provides the group with the nursing, secretarial, billing, collection, and record keeping services needed to carry on its medical practice. In consideration for the office space and services provided, the group is required to pay the hospital a fixed percentage of its gross billings for services rendered to both hospital and private patients.

The hospital has established that the presence of the group practice at the hospital has had the effect of (1) reducing hospital admissions, days of stay, and surgical rates; (2) permitting more efficient use of existing facilities; (3) making more effective use of scarce health manpower; (4) fulfilling the hospital's role as the health center of the community; (5) fixing administrative responsibility in a single group; and (6) making more effective use of hospital facilities for training purposes.

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 the purpose or function constituting the basis for its exemption under section 501.

Section 1.513–1(d)(2) of the Income Tax Regulations provides that a trade or business is "substantially related" to exempt purposes when the business activity has a substantial causal relationship to the achievement of the exempt purposes.

Section 1.514(b)–1(c)(1) of the regulations indicates, by example, that where a tax-exempt hospital leases real property owned by it to an association of doctors for use as a clinic, the rents derived under such lease would not be included in computing unrelated business taxable income if the clinic is substantially related to the carrying on of hospital functions.

A lease by a hospital of part of the hospital to a doctors' association to use as a clinic is generally considered a trade or business related to the carrying on of hospital functions. See S. Rep. No. 2375, 81st Cong., 2nd Sess., C.B. 1950–2, 483 at 507. One definition of the term "clinic" is "a group practice in which several physicians work cooperatively." (Webster's Seventh New Collegiate Dictionary, 1967.) It is held that the group practice described above contributes importantly to the hospital's operations and is therefore substantially related to the carrying on of hospital functions. Accordingly, the leasing activity described above is not unrelated trade or business under section 513 of the Code.

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26 CFR 1.513–1: Definition of unrelated trade or business.

The publication and continuing sale of a book having no substantial causal relationship to the achievement of an exempt purpose. See Rev. Rul. 69–430, page 129.

26 CFR 1.513–1: Definition of unrelated trade or business.

Employees' trust purchasing installment notes from employer-settlor. See Rev. Rul. 69–574, page 130.

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26 CFR 1.513–1: Definition of unrelated trade or business.

The sale of laundry services by a hospital exempt under section 501(c)(3) of the Code to other exempt hospitals. See Rev. Rul. 69–633, page 121.

Section 514.—Business Leases

26 CFR 1.514(b)–1: Definition of business lease.
(Also Section 501; 1.501(c)(3)–1.)

Leases of office space by an exempt hospital to members of its medical staff who contribute importantly to the performance of hospital functions are not considered business leases within the meaning of section 514 of the Code.

Rev. Rul. 69–464

Advice has been requested whether the leases described below are excepted from the definition of the term "business lease" in section 514(b) of the Internal Revenue Code of 1954 by the provisions of section 514(b)(3)(A)(i) of the Code.

A community hospital exempt from Federal income tax under section 501(c)(3) of the Code built an adjacent office building for doctors in order to encourage members of its medical staff to maintain their private medical practices near the hospital. The building is subject to a mortgage incurred at the time of its construction. The hospital leases office space in the building to doctors to carry on their private medical practices. Only members of the hospital's active or courtesy medical staff may lease space, with active staff members given preference. Doctors who do not have staff privileges in the hospital are not accepted as tenants. The usual term of the leases, including options to renew, is for more than five years. However, the lease may be terminated sooner by the hospital in the event that a tenant ceases to be a member of the medical staff. Only janitorial and maintenance services are provided to the tenants by the hospital.

The hospital has established that (1) as a result of having members of its medical staff practicing medicine in offices adjacent to the hospital, greater use is made of the hospital's diagnostic facilities and patient admissions are easier, and (2) the physical presence of the members of the medical staff on the hospital's grounds makes the services of these doctors more readily available for outpatient and inpatient emergencies, facilitates carrying out their everyday medical duties in the hospital, makes their attendance at staff meetings easier, and serves to increase their participation in the hospital's medical education and research programs. While these leasing arrangements are also a convenience to the lessees, many of the benefits are passed on to the hospital and its patients in the form of greater efficiency and better overall medical care.

A charitable organization exempt under section 501(c)(3) of the Code is subject to the unrelated business income tax imposed by section 511 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 five years if at the close of the lessor's taxable year there is a business lease indebtedness, as defined in section 514(c) with respect to such property. However, section 514(b)(3)(A)(i) of the Code provides that no lease shall be considered a business lease if such lease is entered into primarily for purposes which are substantially related (aside from the need of such organization for income or funds or the use it makes of the rents derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

The leasing of office space adjacent to the hospital to members of the medical staff under the circumstances described contributes importantly to the hospital functions by increasing the hospital's efficiency, encouraging fuller utilization of its facilities, and improving the overall quality of its patient care. By leasing only to doctors who have staff privileges, the hospital is leasing the premises on the basis of a criterion that furthers hospital functions. Benefits thus derived from these leases by the hospital and its patients indicate that such leases are entered into primarily for purposes that are substantially related to the performance of hospital functions. Based on the facts presented, it is held that the leases described above come within the provisions of section 514(b)(3)(A)(i) of the Code and are not business leases.

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.
(Also Section 7805; 301.7805–1.)

The sale of by-products to nonproducers by an exempt farmers' cooperative purchasing association may not, after August 4, 1969, be disregarded in computing the fifteen percent limitation of section 521(b)(4) of the Code; Revenue Ruling 54–12 modified.

Rev. Rul. 69–417

The Internal Revenue Service has given further consideration to Revenue Ruling 54–12, C.B. 1954–1, 93, insofar as it relates to the sale of by-products by a farmers' cooperative purchasing association exempt from Federal income tax under section 521 of the Internal Revenue Code of 1954.

Revenue Ruling 54–12 holds that the sale of by-products not usable by farmer patrons could be disregarded for purposes of computing the fifteen percent limitation of section 521(b)(4) of the Code by a farmers' coopera-

tive association engaged in the production and distribution of petroleum products. It also holds that the value of light petroleum fuels exchanged with other refineries in order to effect a saving in transportation costs will be disregarded for purposes of such fifteen percent test.

In Revenue Ruling 54–12, a farmers' cooperative association owned a petroleum refining company that was purchased to assure a continuing supply of petroleum products. In the years prior to the acquisition of the refining company the association purchased petroleum products on the open market. The petroleum refining company was operated as a part of the association's activities for the purpose of producing petroleum fuels required by farmers in the production of their agricultural products. In the production of light petroleum products used by farmers, certain by-products such as heavy fuel oils and distillates were produced which the farmer patrons do not use. These products were sold in whatever market was available. The oil refinery also delivered light petroleum products to the distributing agencies of the other refineries. The other refineries in turn delivered a like quantity of the same products to the distributing agency of the cooperative association from their stocks located at points convenient to the farmer patrons. The exchanges were made to effect a saving in transportation costs.

Section 521(b)(1) of the Code provides for the exemption from Federal income tax of farmers', fruit growers', or like associations organized and operated on a cooperative basis 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 521(b)(4) of the Code allows such an association to make purchases for persons who are neither members nor producers, provided the value of such purchases does not exceed fifteen percent of the value of all the association's purchases.

Where a farmers' cooperative purchasing association manufactures products supplied to the farmer patrons, such manufacture represents a part of the purchasing activity of the association. Therefore, sales of such manufactured products, including by-products, must be taken into account in computing the value of the purchases for persons who are neither members nor producers for purposes of the fifteen percent limitation of section 521(b)(4) of the Code.

Furthermore, in order to establish compliance with the requirement of the Code that supplies and equipment be turned over to members or other persons at actual cost, plus necessary expenses, it is necessary for the association to show that the purchasers of such by-products are entitled to share in the net earnings of the association on the same basis as all other patrons of the association.

Accordingly, Revenue Ruling 54–12 is modified to remove therefrom the conclusion that the sale of by-products can be disregarded for purposes of computing the fifteen percent limitation of section 521(b)(4) of the Code. However, the holding in Revenue Ruling 54–12 that the value of petroleum products exchanged with other refineries in order to effect a saving in transportation costs shall for purposes of such fifteen percent test be disregarded remains in effect.

Under authority granted by section 7805(b) of the Code, this Revenue Ruling will be applied only to taxable years beginning after August 4, 1969, the date of its publication in the Internal Revenue Bulletin.

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26 CFR 1.521–1: Farmers' cooperative marketing and purchasing associations; requirements for exemption under section 521.

A farmers' cooperative association does not qualify for exemption under section 521 of the Code where stockholders are permitted to participate in the profits of the association beyond the amount of dividends payable on their stock.

Rev. Rul. 69–431

Advice has been requested whether a farmers' cooperative association is exempt from Federal income tax under section 521 of the Internal Revenue Code of 1954 where its stockholders are permitted to share as stockholders in the profits of the association beyond the fixed dividends upon dissolution or upon redemption of their stock.

The association's articles of incorporation provide that, in addition to fixed dividends, common stock shall be redeemed at the price originally paid for it plus a share of the profits accumulated as a reasonable reserve and a share of the profits on sale of assets used in the business. The association has been redeeming common stock in accordance with its charter provisions. As a result, retiring stockholders have been receiving more for their stock than they paid for it.

Section 521(b)(1) of the Code provides for the exemption from Federal income tax of farmers' cooperative associations organized and operated on a cooperative basis 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 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 521(b)(2) of the Code provides that an exempt cooperative may issue capital stock if the maximum statutory dividend rate is not exceeded, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends) is owned by producers who market their products or purchase their supplies and equipment through the association.

While the Code does not specifically cover the participation rights of stockholders in the profits of an exempt cooperative in the event of dissolution or stock redemption (other than the holders of nonvoting preferred stock), section 521(b)(1) of the Code does require operation at cost in that all net earnings from marketing and purchasing must be returned to patrons on the basis of their patronage. This includes any earnings set aside for surplus or reserves. *Fertile Cooperative Dairy Association* v. *Huston,* 119 F. 2d 274 (1941), Ct. D. 1527, C.B. 1941–2, 180. Moreover, since an exempt farmers' cooperative is required to operate for the benefit of its patrons, earnings from nonpatronage sources (such as that derived from investments, the sale of assets, and business done with or for the United States) must also be distributed to the patrons on a patronage basis.

Therefore, although stockholders may share in the profits of an exempt farmers' cooperative, they may do so only on the basis of their patronage rather than on the basis of shares of stock that they may own. Neither common nor preferred stockholders may participate in the profits of an exempt farmers' cooperative, upon dissolution or otherwise, beyond the fixed dividends.

Since the association's stockholders have been participating in the profits of the association beyond the fixed dividends, it is held that it does not qualify for exemption from Federal income tax under section 521 of the Code.

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26 CFR 1.521–1: Farmers' cooperative marketing and purchasing associations; requirements for exemption under section 521.

Farmers' cooperative associations will lose their exempt status under section 521 of the Code if subsidiary corporations established to handle nonmember-nonproducer business fails to pay patronage dividends to nonmember patrons or violates the fifteen percent limitation on purchases.

Rev. Rul. 69–575

Advice has been requested whether the described farmers' cooperative associations lose their status as organizations exempt from Federal income tax under section 521 of the Internal Revenue Code of 1954 by the creation of subsidiary corporations to handle nonmember-nonproducer business in the manner set forth below.

Cooperatives *X* and *Y* are agricultural cooperative purchasing associations incorporated to purchase farm supplies and equipment for farmers and other patrons. The members are farmers who purchase farm supply items through the cooperatives. Both associations have been held exempt from Federal income tax under section 521 of the Code.

X, which was organized to furnish its farmer patrons with supplies and equipment used in their farming operations, has operated several retail stores for many years. It has supplied its patrons with items, such as fertilizer, vegetable seeds, and farm implements, which may also be used by nonfarmers. The area in which it operates experienced a trend toward urbanization, accompanied by a decrease in farming activity. Due to this urbanization, the number of nonmember-nonproducer patrons increased to a point where the value of their annual purchases was approaching fifteen percent of the value of total purchases. At this point the cooperative created a subsidiary corporation to handle its nonmember-nonproducer business. In exchange for the stock of the new corporation, *X* transferred to the subsidiary the inventories, office and truck equipment, and accounts receivable of the nonmember-nonproducer business and enough cash to provide working capital for the new corporation. The subsidiary pays patronage dividends to its patrons. In the year in question the subsidiary's purchases for nonmember-nonproducers exceeded fifteen percent of the combined purchases of the subsidiary and *X.*

Y also organized a wholly owned subsidiary corporation to handle all sales made to nonmember-nonproducer patrons. All profits are treated by the subsidiary as taxable income and the net profit is turned over to Cooperative *Y* as nonpatronage income. No patronage dividends are paid to the patrons of the subsidiary corporation. In the year in question the subsidiary's purchases for nonmember-nonproducers was less than fifteen percent of the combined purchases of the subsidiary and *Y.*

Section 521(b)(1) of the Code provides for the exemption from Federal income tax of farmers', fruit growers', or like associations organized and operated on a cooperative basis for the purpose of purchasing supplies and equipment for the use of members of other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses.

Section 521(b)(4) of the Code provides that an association that purchases supplies and equipment for nonmember-nonproducer patrons will not for such reason be denied exemption, provided the value of the purchases made for persons who are neither members nor producers does not exceed fifteen percent of the value of all its purchases.

Section 1.521–1(a) of the Income Tax Regulations provides that nonmember patrons must be treated the same as members insofar as the distribution of patronage dividends is concerned.

A farmers' cooperative association that is exempt under section 521 of the Code may establish and control a subsidary corporation so long as the activities of the subsidiary are activities that the cooperative itself might engage in as an integral part of its operations without affecting its exempt status. However, an exempt cooperative may not utilize a subsidiary for the conduct of operations on an ordinary profit-making basis. See S. Rept. 52, 69th Cong., 1st Sess., C.B. 1939–1 (Part 2), 332, at 350.

With respect to *X* the operations of the subsidiary could not be conducted

as an integral part of an exempt purchasing cooperative because such operations would violate the fifteen percent limitation in section 521(b)(4) of the Code. Therefore, *X* lost its exempt status because of the operation of the subsidiary in the manner described.

With respect to *Y* the operations of the subsidiary could not be conducted as an integral part of an exempt purchasing cooperative because the subsidiary paid no patronage dividends as required by section 1.521–1(a) of the regulations. Therefore, *Y* lost its exempt status because of the operation of the subsidiary in the manner described.

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26 CFR 1.521–1: Farmers' cooperative marketing and purchasing associations; requirements for exemption under section 521.
(Also Section 7805; 301.7805–1.)

Examples illustrate the application of the principle of "looking through" to ultimate patrons of member associations in determining whether a federated farmers' cooperative meets the requirements for exemption under section 521 of the Code.

Rev. Rul. 69–651

The Internal Revenue Service has been asked to discuss the circumstances under which a federated farmers' cooperative qualifies for exemption from Federal income tax under section 521 of the Internal Revenue Code of 1954. A federated farmers' cooperative (commonly known as a "federated") is an association whose membership includes farmers' cooperative associations.

Section 521 of the Code sets forth the requirements that a farmers' cooperative association must meet to qualify for exemption. In general, these requirements contemplate that exempt cooperatives will be controlled by their producer-patrons, that they must deal with their patrons at cost plus necessary expenses, and that their activities will consist of doing business with producer-patrons who market their products or purchase their supplies and equipment through the cooperatives.

Farmers' cooperatives may join together to form a federated cooperative to perform more efficient marketing or purchasing functions on behalf of the patrons of the member cooperatives. Since a federated serves the interests of the patrons of its member cooperatives, it is held that it is necessary to look to the patrons of the member cooperatives to determine whether the federated meets the requirements of section 521(b) of the Code. In making that determination, the federated is considered to be dealing directly with the patrons of its member cooperatives. Likewise, in determining control of the federated, it is held that it is necessary to consider the composition of membership of the member cooperatives.

The situations described below illustrate the application of this principle in determining whether a federated meets the requirements of section 521 of the Code. Although the situations involve purchasing cooperatives, the conclusions are equally applicable to marketing cooperatives.

Situation 1

A federated is engaged in purchasing farm supplies exclusively for its member cooperatives at cost plus necessary expenses. In its immediate dealings with its member cooperatives the federated meets the requirements for exemption. All the member cooperatives are exempt from Federal income tax under section 521 of the Code.

As stated previously, in determining whether a federated meets the requirements for exemption under Section 521 of the Code, the federated is considered to be dealing with the patrons of its members. Thus, it is necessary to look to these patrons to determine whether the federated meets the requirements of section 521(b) of the Code.

However, where a member cooperative is itself exempt under section 521 of the Code and accordingly has demonstrated its compliance with that section and where the above facts exist it is assumed that the federated cooperative meets the requirements of section 521 in its dealings with the patrons of that member. Consequently, where all members of the federated cooperative meet the requirements of section 521 as to dealings with patrons and stock ownership, it is similarly assumed under these facts that the federated cooperative also meets those requirements. If each member cooperative individually meets those requirements, they also meet them collectively.

Therefore, because all of the member cooperatives of this federated cooperative are exempt from Federal income tax under section 521 of the Code and since it deals with them exclusively at cost plus necessary expenses, it is held that the federated cooperative qualifies for exemption from Federal income tax under section 521.

Situation 2

A federated is engaged solely in purchasing supplies for its members, some of which are nonexempt cooperatives. The member cooperatives purchase all of their supplies for their patrons from the federated. At the close of each year the federated distributes its net earnings to its member cooperatives on a patronage basis.

The exempt member cooperatives distribute their net earnings on a patronage basis to their patrons, members and nonmembers alike. However, the nonexempt cooperatives distribute their net earnings only to members even though they purchase supplies for both members and nonmembers.

Section 521(b)(1) of the Code provides for exemption from Federal income tax of farmers' cooperative purchasing associations that purchase supplies and equipment for the use of members or other persons, and turn over such supplies and equipment to them at actual cost, plus necessary expenses.

Some of the supplies purchased by the federated are sold by its nonexempt

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member cooperatives for more than the actual cost plus necessary expenses of such supplies. If the federated were exempt under section 521 of the Code, it could not sell these supplies directly to the patrons of their member cooperatives on other than an actual cost basis plus necessary expenses. See *Farmers Co-operative Co. of Wahoo, Nebraska,* v. *United States,* 23 F. Supp. 123 (1938); *Farmers Union Co-op, Co., of Guide Rock, Nebraska,* v. *Commissioner,* 90 F. 2d 488 (1937); *Farmers Union Co-operative Oil Company, Nelson, Nebraska,* v. *Commissioner,* 38 B.T.A. 64 (1938). The federated may not be permitted to do indirectly what it cannot do directly.

Because some of the member cooperatives do not turn over the supplies and equipment purchased from the federated to all patrons, members and nonmembers alike, at actual cost plus necessary expenses, it is held that the federated does not meet the requirements of section 521 of the Code.

Situation 3

The facts here are the same as those in *Situation 2* except that the nonexempt cooperative members distribute their net earnings on a patronage basis to members and nonmembers alike.

The value of the supplies purchased by the federated and turned over by the member cooperatives to their patrons was $2,800,000. Of that amount, $2,000,000 was turned over to members and $800,000 to nonmembers. Of the latter amount, $500,000 was turned over to persons who are neither members nor producers.

Section 521(b)(4) of the Code provides that exemption shall not be denied a farmers' purchasing cooperative that purchases supplies and equipment for nonmembers in an amount the value of which does not exceed the value of the supplies and equipment purchased for members, provided the value of the purchases made for persons who are neither members nor producers does not exceed 15 percent of the value of all its purchases.

In applying these limitations to a federated, there are two statutory tests: first, the value of the federated's supplies turned over to nonmembers of the member cooperatives may not exceed the value of its supplies turned over to members of such cooperatives; second, the value of the federated's supplies turned over to nonmember nonproducers of the member cooperatives may not exceed 15 percent of the value of its supplies turned over to all patrons of the member cooperatives.

The federated meets the first test because the value of supplies turned over to nonmembers does not exceed the value of supplies turned over to members. However, it fails to meet the second test because more than 15 percent (17.9 percent) of the total value of the supplies was turned over to nonmember-nonproducers. Therefore, the federated does not meet the requirements of section 521(b)(4), and accordingly, it is held that it does not qualify for exemption under section 521 of the Code.

Situation 4

A federated is engaged exclusively in purchasing supplies for its five member cooperatives, one of which is a nonexempt farmers' cooperative. The member cooperatives purchase all of their supplies for their patrons from the federated. Each exempt cooperative owns one share of common stock in the federated and the nonexempt member owns three shares. Each share entitles the holder to one vote in the affairs of the federated. Thus, the nonexempt cooperative owns three of the seven outstanding shares of voting stock. The nonexempt cooperative has several hundred members, but only 40 percent of them are producers who patronize the cooperative.

Section 521(b)(2) of the Code, relating to the requirements for exemption under section 521, provides that substantially all of the capital stock issued by a cooperative must be owned by producers who market their products or purchase their supplies and equipment through the cooperative. The only exception is nonvoting preferred stock with no participation rights in the profits on dissolution, or otherwise, beyond the fixed dividends.

Substantially all of the federated cooperative's stock, not falling within the above exception, must be held by producers who purchase the federated cooperative's supplies. In order to determine whether substantially all of the stock of the federated cooperative is owned by producer patrons, it is necessary to look to the membership of the member cooperatives.

Inasmuch as the nonexempt cooperative owns about 42 percent of the federated cooperative's stock and 60 percent of its members are nonproducers, at least 25 percent of the federated cooperative's stock is owned indirectly by nonproducers. Since substantially all of the federated cooperative's stock is not owned by producers who purchase the federated cooperative's supplies, it is held that the federated cooperative does not qualify for exemption from Federal income tax under section 521 of the Code.

Even though an organization considers itself within the scope of *Situation* 1 of this Revenue Ruling, it must file an application on Form 1028, Exemption Application, in order to be recognized by the Service as exempt under section 521 of the Code. The application should be filed with the District Director of Internal Revenue for the district in which is located the principal place of business or principal office of the organization. See section 1.521–1(e) of the Income Tax Regulations.

Under the authority contained in section 7805(b) of the Code, the provisions of this Revenue Ruling as set forth in *Situations* 2 through 4 will not be applied to a taxable year beginning before July 1, 1970, with respect to federated cooperative associations that have been relying upon rulings or determination letters of exemption issued under section 521.

Subchapter G. Corporations Used To Avoid Income Tax on Shareholders

Part II. Personal Holding Companies

Section 542.—Definition of Personal Holding Company

A parent of an affiliated group engaged in the lending and finance business must include in gross income intercorporate interest and managerial fees received from subsidiaries for purposes of determining whether it is a personal holding company.

Rev. Rul. 69–588

Advice has been requested regarding the treatment of intercorporate interest and the share of managerial fees received by a corporation from its subsidiaries, for the purpose of determining whether the corporation may be excluded from the definition of a personal holding company, under section 542(c)(6) of the Internal Revenue Code of 1954.

Y, a loan company, is engaged in the lending and finance business. It owns all of the capital stock of several loan companies also engaged in the same business. *Y*, in addition to conducting its own business of making loans, manages all the subsidiaries. It arranges for their financing, by borrowing money in its own name and lending some of the borrowed funds to the subsidiaries. *Y* charges the subsidiaries interest on the loans made to them based upon the average outstanding monthly loan balances. Total interest paid by *Y* for 1968 was 95*x* dollars. *Y* received 65*x* dollars in interest income from its subsidiaries attributable to loans it made to them. *Y*'s expenses for managerial services for the overall operation of its own business as well as its subsidiaries were 60*x* dollars. *Y* charged its subsidiaries 50*x* dollars for the managerial services rendered to them for 1968.

The specific question presented is whether, for the purpose of the percentage of ordinary gross income requirement of section 542(c)(6) of the Code, the 65*x* dollars of interest, and the 50*x* dollars for managerial services received by *Y* from its subsidiaries, must be included in the gross income of *Y*, for 1968, or may be used as an offset (netted out) against the total interest 95*x* dollars and the total managerial expenses of 60*x* dollars, respectively.

Section 542(c)(6) of the Code, effective for taxable years beginning after December 31, 1963, excludes certain lending and finance companies from personal holding company status. Section 542(c)(6)(A) of the Code provides that the term "personal holding company" as defined in section 542(a) of the Code does not include a lending or finance company if 60 percent or more of its *ordinary gross income,* as defined in section 543(b)(1) of the Code, is derived directly from the active and regular conduct of a lending or finance business.

Section 543(b)(1) of the Code defines "ordinary gross income" to mean gross income excluding (1) all gains from the sale or other disposition of capital assets, (2) all other gains from the sale or other disposition of property described in section 1231(b) of the Code and (3) in the case of certain foreign corporations, all items which would otherwise constitute personal holding company income under section 543(a) of the Code except paragraph (7) thereof.

Section 542(d) of the Code provides special rules for applying section 542(c)(6) of the Code. Section 542(d)(1)(A) of the Code provides, in pertinent part, that the term "lending or finance business" includes a business of rendering services or making facilities available to another corporation which is engaged in the lending or finance business, if such services or facilities are related to the lending or finance business of such other corporation and the corporation rendering services and making facilities available are members of the same affiliated group as defined in section 1504 of the Code.

The Report of the Senate Committee on Finance, in explaining the enactment of section 542(d)(1) of the Code states, in part, that the definition of a lending or finance business has been amended to make it clear that this includes income from rendering services or making facilities available to another member of an affiliated group which is also in the lending or finance business. This is provided because as a matter of economical operations, one company frequently hires necessary personnel, acquires appropriate facilities, and in accordance with the requirements of banks, borrows all of the money for the group. Then all of the corporations in the group pay a service charge for these services to the company performing them. See Senate Report No. 830, Eighty-eighth Congress, C.B. 1964–1 (Part 2), 505, at 615.

In view of the above, the starting point in determining ordinary gross income, under section 543(b)(1) of the Code, is gross income under section 61 of the Code. The interest received by *Y* is includible in its gross income. The apparent intent of Congress was to include in gross income the income from the rendering of the services, as in the instant case, and to consider a corporation rendering such services as being in the lending or finance business. Accordingly, it is held that in determining its ordinary gross income, for the purposes of section 542(c)(6) of the Code, *Y* must include in its gross income not only the 65*x* dollars of interest charged to its subsidiaries but also the 50*x* dollars charged to its subsidiaries for services rendered.

Section 545.—Undistributed Personal Holding Company Income

26 CFR 1.545–2: Adjustments to taxable income.
(Also Sections 111, 461; 1.111–1, 1.461–2.)

In determining undistributed personal holding company income, Federal income tax deficiencies contested but paid are deducted in the year paid if allowable under section 461(f) of the Code, and recovered amounts are included in the

year of recovery unless excludable under section 111(c)(2).

Rev. Rul. 69–620

Advice has been requested whether a Federal income tax deficiency that is contested but paid qualifies as an adjustment to taxable income, under section 545(b) of the Internal Revenue Code of 1954, in determining undistributed personal holding company income.

In 1968, the Tax Court of the United States found that *X* corporation had underpaid its 1964 Federal income taxes. *X* paid the amount of the deficiency in June 1968 and later that year appealed the decision. In determining its undistributed personal holding company income for the calendar year 1968 under section 545 of the Code, *X* deducted the amount of the contested taxes paid.

Section 545 of the Code provides for adjustments to be made to the taxable income of a personal holding company in order to arrive at the undistributed personal holding company income for purposes of the tax imposed on personal holding companies. Section 545(b)(1) of the Code states that taxable income "shall be adjusted" by allowing "as a deduction" accrued Federal income taxes.

Section 1.545–2(a)(1)(i) of the Income Tax Regulations provides, in part, that, in computing the amount of taxes accrued, an *unpaid* tax that is being contested is not considered accrued until the contest is resolved. However, section 461(f) of the Code provides, in relevant part, that if (1) the taxpayer contests an asserted liability, (2) the taxpayer transfers money or other property to provide for the satisfaction of the asserted liability, (3) the contest with respect to the asserted liability exists after the time of the transfer, and (4) but for the fact that the asserted liability is contested, a deduction would be allowed for the taxable year of the transfer (or for an earlier taxable year), then the deduction shall be allowed for the taxable year of the transfer.

Thus, if the conditions prescribed in section 461(f) of the Code are satisfied, the payment of a contested tax is allowable as a deduction for the taxable year during which paid, and the above-stated provision of section 1.545–2(a)(1)(i) of the regulations is not applicable.

Accordingly, in determining undistributed personal holding company income of corporation *X* the deduction allowed by section 545(b)(1) of the Code includes the asserted Federal income tax deficiency that was paid even though it was contested. The deduction for the contested tax is allowable for the taxable year 1968 during which money was transferred to provide for the satisfaction of the asserted tax liability.

In the event that the taxpayer is wholly or partially successful in its contest of the tax deficiency and recovers as a result thereof in a later taxable year all or a portion of the sum that it deducted, the amount recovered shall be included in determining the taxpayer's undistributed personal holding company income in the year of recovery unless a recovery exclusion is available under section 111(c)(2) of the Code. Under the terms of that section, such recovery would be excludable only if the previous deduction did not result in a reduction of the personal holding company tax imposed by section 541 of the Code.

Subchapter H. Banking Institutions

Part I. Rules of General Application to Banking Insitutions

Section 583.—Deductions of Dividends Paid on Certain Preferred Stock

For the purpose of the deduction provided by section 583 of the Code, dividends on preferred stock paid by banks to the United States or an instrumentality thereof must be actually or constructively paid during the taxable year; G.C.M. 18676 superseded.

Rev. Rul. 69–564 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute, the position set forth in G.C.M. 18676, C.B. 1937–2, 140.

The question presented is whether the deduction provided by section 583 of the Internal Revenue Code of 1954, relating to dividends on preferred stock paid by banks to the United States or to an instrumentality of the United is allowable only as to such dividends actually paid or whether a deduction may be allowed for such dividends accrued.

Section 583 of the Code provides as follows:

"In computing the taxable income of any national banking association, or of any bank or trust company organized under the laws of any State, Territory, possession of the United States, or the Canal Zone, or of any other banking corporation engaged in the business of industrial banking and under the supervision of a State banking department or of the Comptroller of the Currency or of any incorporated domestic insurance company, there shall be allowed as a deduction from gross income, in addition to deductions otherwise provided for in this subtitle, any dividend (not including any distribution in liquidation) paid, within such taxable year, to the United States or to any instrumentality thereof exempt from Federal income taxes, on the preferred stock of the corporation owned by the United States or such instrumentality. The amount allowable as a deduction under this section shall reduce the dividends paid otherwise computed under section 561."

It is held that since the language of section 583 is unequivocal any such dividend is allowable as a deduction from gross income in the taxable year that it is paid. Actual payment is necessary except where there has been constructive payment, that is, where the dividend has been declared and has been made unqualifiedly subject to the

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

demand of the stockholder which is the United States or an instrumentality thereof.

G.C.M. 18676 is hereby superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

Part II. Mutual Savings Banks, etc.

Section 591.—Deduction for Dividends Paid on Deposits

26 CFR 1.591–1: Deduction for dividends paid on deposits.
(Also Section 451; 1.451–2.)

Treatment of interest on long-term savings deposit certificates of savings and loan associations where withdrawal prior to the conclusion of the term is permitted only in an emergency and requires the certificate holder to forfeit all accrued interest.

Rev. Rul. 69–638

Advice has been requested as to the Federal income tax treatment of interest on savings deposit certificates issued by a savings and loan association under the circumstances described below.

The taxpayer, a savings and loan association, issues certificates of deposit for terms of three, four, or five years with interest accruing from the date of deposit and continuing to the conclusion of the term at a rate of not less than 5¼ percent compounded daily but payable at the conclusion of the term. No withdrawal of principal or interest is permitted prior to the conclusion of the original term or any renewal period, except in the case of emergency where withdrawal is necessary to prevent great hardship to a certificate holder. In such case, the taxpayer may, in its discretion, permit withdrawal of the entire deposit but, in such event, all accrued and unpaid interest is forfeited by the certificate holder.

The certificates are automatically renewed at the conclusion of the original term or any renewal period for successive periods of three, four, or five years unless presented for withdrawal not later than ten days after the conclusion of the original term or any renewal period. The taxpayer reserves the right not to renew such certificates by giving written notice to the depositor at least ten days prior to the conclusion of the original term or any renewal period.

Section 1.591–1(b) of the Income Tax Regulations provides in pertinent part that if a savings and loan association maintains a bonus plan, or issues shares, or accepts deposits, subject to fines, penalties, forfeitures, or other withdrawal fees, it may deduct under section 591 of the Internal Revenue Code of 1954 the total amount credited as dividends or interest upon such shares or deposits, notwithstanding that as a customary condition of withdrawal such association has the right, pursuant to by-law, contract, or otherwise, to retain or recover a portion of the total amount invested in, or credited as earnings upon such shares or deposits, such bonus account, as a fine, penalty, forfeiture, or other withdrawal fee. In any taxable year in which such right is exercised, there is includable in the gross income of the association for such taxable year amounts retained or recovered by it pursuant to the exercise of such right.

Section 1.451–2(a) of the regulations provides, in pertinent part, that income although not actually reduced to a depositor's possession is constructively received by him in the taxable year during 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 depositor's control of its receipt is subject to substantial limitations or restrictions.

Revenue Ruling 66–45, C.B. 1966–1, 95, points out that the phrase "or otherwise made available" was added to section 1.451–2 of the regulations to make it clear that it is the 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.

It is held that the interest credited with respect to the savings deposit certificates is deductible by the taxpayer in the taxable year credited. If a certificate holder withdraws the entire deposit as a result of the "emergency provision", the taxpayer must include in its gross income for that taxable year the entire amount of interest previously credited and deducted for Federal income tax purposes with respect to the certificate.

It is further held that since the certificate holder is precluded from withdrawing from his account except in the case of emergency and then only by forfeiting all accrued and unpaid interest, the interest credited by the taxpayer with respect to the certificate is not includible in the certificate holder's gross income until the taxable year in which the original term of the certificate has been concluded. At that time, even if the certificate holder does not exercise his option to withdraw, he will be considered to have constructively received the entire amount of interest accrued during the original term. Any renewal of the original term of a certificate will be treated as a new certificate as far as the Federal income tax treatment of the interest earned thereon is concerned.

See, however, Revenue Ruling 69–147, C.B. 1969–1, 165, with respect to the treatment of interest on short-term certificates.

Section 593.—Reserves for Losses on Loans

26 CFR 1.593–10: Certain distributions to shareholders by a domestic building and loan association.
(Also Section 381; 1.381(c)(4)–1.)

Section 593(f) of the Code is inapplicable to the liquidation pursuant to section 332, of a wholly-owned subsidiary by its parent, where both are domestic building and loan associations, and the parent carries over the subsidiary's bad debt reserves under section 381.

Rev. Rul. 69–374

X, a domestic building and loan association as defined in section 7701(a)(19) of the Internal Revenue Code of 1954, liquidated *Y*, a wholly-owned subsidiary which was also a domestic building and loan association, pursuant to section 332 of the Code in a transaction in which the basis of the assets transferred was computed under section 334(b)(1). *X* continued to operate as a building and loan association. The reserves for bad debts established and maintained by *Y* under the provisions of section 593(c) were carried over by *X* pursuant to section 381 and maintained as part of its own reserves after the liquidation of *Y*.

Held, *Y* is not required to include in its gross income the balance in its reserves for bad debts at the date of liquidation. Since the provisions of section 381 are applicable to the liquidation of *Y*, the provisions of section 593(f) are inapplicable.

Subchapter I. Natural Resources

Part I. Reductions

Section 611.—Allowance of Deduction for Depletion

26 CFR 1.611–1: Allowance of deduction for depletion.
(Also Section 613; 1.613–1.)

Where an economic interest is retained in the sand and gravel on a farm, the income derived from extraction is ordinary income subject to depletion under sections 611 and 613 of the Code.

Rev. Rul. 69–466

Advice has been requested whether income received by a taxpayer upon the disposition of sand and gravel, under the circumstances described below, is ordinary income subject to depletion under sections 611 and 613 of the Internal Revenue Code of 1954, or is income subject to the treatment provided by section 1231 of the Code, relating to gains or losses from sales or exchanges of property used in a trade or business.

The taxpayer, owner of a dairy farm for more than six months, entered into a written contract with a road building contractor for the disposition of sand and gravel from his farm. The road building contractor was granted the right to go on the farm and remove sand and gravel. No specific area was designated by the written contract from which the sand and gravel was to be excavated, but the taxpayer orally designated the portions of the farm, and the depth, where the excavation was to be carried on. There was no requirement in the contract that any or all of the sand and gravel must be removed and no requirement that the sand and gravel must be removed within any definite period of time. The excavated areas were to be left in a levelled and graded condition.

The contractor agreed to pay the taxpayer a stated amount per cubic yard of sand and gravel removed from the designated areas. However, there was no requirement that the contractor make any payment to the taxpayer except as the sand and gravel was removed. The taxpayer received no payment when the contract was executed. The written contract did not provide for termination by either party. The taxpayer continued to pay real property taxes on the farm including that portion from which sand and gravel was excavated.

The contractor excavated sand and gravel, from an area of the farm designated by the taxpayer, only during the time sand and gravel was required by the contractor for its road building project near the excavation site. At the completion of the road building project all mining activity ceased. The excavated area was levelled and the farm fences replaced.

Section 611(a) of the Internal Revenue Code of 1954 provides for the allowance of depletion. Sand and gravel are identified as separate minerals in section 613(b)(6)(A) of the Code. Percentage depletion at the rate of five percent is provided by that section for these minerals.

Section 611–1(b)(1) of the Income Tax Regulations states that an "economic interest is possessed in every case in which the taxpayer has acquired by investment any interest in mineral in place * * *, and secures, by any form of legal relationship, income derived from the extraction of the mineral * * *, to which he must look for a return of his capital."

The courts recently have considered contracts involving payments to landowners upon the production of minerals in instances similar to that described above. See *Royalton Stone Corp.* v. *Commissioner*, 379 F. 2d 298 (1967), cert. denied 389 U.S. 978 (1967); *Walter R. and Marguerite Laudenslager* v. *Commissioner*, 305 F. 2d 686 (1962), cert. denied 371 U.S. 947 (1963); *W. W. Oliver, Sr.* v. *United States*, 408 F. 2d 769 (1969); *Nathaniel C. Wood* v. *United States*, 377 F. 2d 300 (1967), cert. denied, 389 U.S. 977 (1967); *Ralph G. and Loretta C. Gitzinger* v. *United States*, 404 F. 2d 191 (1968); *Del and Maryetta Freund* v. *United States*, 367 F. 2d 776 (1966); *Louis and Lena Rabiner* v. *Bacon*, 373 F. 2d 537 (1967); *Melvin L. Hair and Esther Hair* v. *Commissioner*, 396 F. 2d 6 (1968); *United States* v. *Paul R. and Anna Lee White*, 401 F. 2d 610 (1968).

The question in each of the above cited cases was whether the taxpayer sold an asset or leased mineral property retaining an economic interest. In each of these cases the courts held that the taxpayer retained a continuing interest in the mineral property in question and that the retention of the continuing interest resulted in ordinary income to the taxpayer. The income received by the taxpayer from the extraction and sale of mineral from the property coupled with an investment in the property was held to satisfy the economic interest test, first announced in *E. G. Palmer* v. *Bender*, 287 U.S. 551 (1933), Ct. D. 641, C.B. XII–1, 235 (1933), now incorporated in section 1.611–1(b)(1) of the regulations.

The transaction in the instant case between the taxpayer and the contrac-

tor was simply an arrangement whereby the contractor was granted the right to excavate and remove sand and gravel from the taxpayer's farm in return for a royalty for each cubic yard of material taken. The payment to the taxpayer was dependent upon extraction. The contractor did not undertake to extract and remove all or any specified quantity of sand and gravel from any particular area of the taxpayer's farm. The taxpayer received income only upon the extraction of sand and gravel and the total amount to be paid to the taxpayer was not fixed. The taxpayer continued to own the material in place until it was removed, truckload by truckload.

Within the criteria of the *Palmer* case, the taxpayer secured by a legal relationship income derived from the extraction of sand and gravel to which he was required to look for the return of his capital investment and, therefore, he retained an economic interest in the sand and gravel. Accordingly, the income received by the taxpayer on account of his retained economic interest in the sand and gravel on his farm is ordinary income subject to depletion under sections 611 and 613 of the Internal Revenue Code of 1954 and not subject to the treatment provided by section 1231 of the Code.

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26 CFR 1.611–1: Allowance of deduction for depletion.
(Also Section 167; 1.167(a)–5.)

The price paid for a going mining enterprise is allocable to the various assets acquired, including mineral leases or mineral properties, in the proportion that the fair market value of each bears to the total fair market value of all acquired assets.

Rev. Rul. 69–539

The Internal Revenue Service has been asked to state its position with respect to the memorandum opinions of the Tax Court of the United States in *Island Creek Coal Co.* v. *Commissioner,* T.C. Memo. 1962–138 and *Island Creek Coal Co.* v. *Commissioner,* T.C. Memo. 1966–103. Each of these opinions considered the allocation of the total cost of a going coal mining enterprise, purchased by the taxpayer, to its various assets for the purpose of determining the basis of each asset. No cost basis was allocated to the depletable coal leases acquired in the transaction in the first case and only a nominal basis in the second. In effect, therefore, the entire purchase price of the enterprise in each case was allocated to the depreciable assets acquired in the transaction. The court accepted the taxpayer's allocation because of two findings of fact: first, that the value of the depreciable property equaled or exceeded the purchase price, and second, that the mineral leases acquired had no value apart from the royalties which the taxpayer was obligated to pay when it assumed the ownership and operation of the leases. Because these determinations were factual, the decisions were not appealed.

Only in rare and extraordinary circumstances will a taxpayer acquire a going enterprise in which the mineral leases have no value apart from the royalty that they specify for the lessor. In each of the cases cited below the Supreme Court of the United States or the Board of Tax Appeals, found that the leases involved therein had a value above the royalties paid. *Margaret C. Lynch, Executrix of the Last Will and Testament of E. J. Lynch* v. *Alworth-Stephens Company,* 267 U.S. 364 (1925), T.D. 3690, C.B. IV–1, 162 (1925); *Eli J. Taylor* v. *Commissioner,* 9 B.T.A. 442 (1927), acquiescence, C.B. VII–1, 31 (1928); *Marsh Fork Coal Co.* v. *Commissioner,* 11 B.T.A. 685 (1928), acquiescence, C.B. VIII–1, 29 (1929), reversed on other points, 42 F. 2d 83 (1929); *Milby & Dow Coal and Mining Company* v. *Commissioner,* 24 B.T.A. 40 (1931), acquiescence, C.B. IX–2, 6 (1932).

A mineral lease is a mineral property that is separate from the lessor's royalty interest. Section 1.611–1(d)(1) of the Income Tax Regulations. The value of such a mineral lease is determined under the methods set forth in section 1.611–2(d) of the regulations which provides for methods of determining the fair market value of mineral properties and improvements, if any. Analytical appraisal methods of valuation, such as the "present value" method, in which future earnings are discounted to present worth, will not be used, if the value of a mineral property and any improvements can be determined upon the basis of cost or comparative values and replacement value of equipment or if the fair market value can reasonably be determined by any other method.

Once the value of the mineral lease or mineral property is established, basis is allocated pursuant to section 1.611–1(d)(4) of the regulations which provides that when a mineral enterprise is acquired as a unit, the cost of any interest in the mineral deposit or deposits is that proportion of the total cost of the mineral enterprise which the value of the interest in the deposit or deposits bears to the value of the entire enterprise at the time of its acquisition. A similar allocation in the case of the depreciable property is required under section 1.167(a)–5 of the regulations. For example, the Tax Court of the United States allocated the purchase price between tangible and intangible assets in *Copperhead Coal Co.* v. *Commissioner,* T.C. Memo. 1958–9, affirmed, 272 F. 2d 45 (1959), and *Philadelphia Steel & Iron Corporation* v. *Commissioner,* T.C. Memo. 1964–93, affirmed, *per curiam,* 344 F. 2d 964 (1965). Thus, even though the depreciable assets may be worth the entire purchase price, it does not follow that nothing should be allocated to the depletable assets. See *F. & D. Rentals, Inc.* v. *Commissioner,* 44 T.C. 335 (1965), in which the court said:

* * * [I]t is now well settled that the Commissioner is not bound to accept an artificial and unrealistic allocation of lump-sum purchase price made by the seller and purchaser; rather the Commissioner may in such circumstances make an independent allocation of his own, assigning portions of

the aggregate purchase price to individual assets or groups of assets in accordance with their relative values and in accordance with the realities of the transaction * * *.

Accordingly, it is held that the price paid for a going mining business must be allocated to each asset or group of assets acquired, including the mineral lease or mineral property, in the proportion that the fair market value of each bears to the total fair market value of all the assets acquired. See section 1.611–1(d)(4) of the regulations. These values depend on the facts and circumstances in the particular case.

Section 612.—Basis for Cost Depletion

26 CFR 1.612–3: Depletion; treatment of bonus and advanced royalty.

Treatment of first-year rental payment on a noncompetitive oil and gas lease application and amounts received upon assignment of rights under the application to a third party with retention of an overriding royalty; Revenue Ruling 56–252 amplified.

Rev. Rul. 69–467

Advice has been requested as to the Federal income tax treatment of (1) an amount paid by a taxpayer as a first-year rental payment on a noncompetitive oil and gas lease application, and (2) the amounts received from a third party for the subsequent assignment of the rights under the application and upon the later granting of a lease.

Oil and gas leases may be acquired on a noncompetitive basis on those Federal lands that are not within a known geological structure, by filing an application for a lease accompanied by the payment of a filing fee and a first-year advance rental to the Bureau of Land Management of the United States Department of the Interior. If the application is withdrawn or rejected without the granting of a lease, the first-year advance rental payment is returned to the applicant. Generally, such leases are acquired by a drawing to determine which applicant will get the right to lease. The taxpayer in the instant case filed such an application and paid the required filing fee and first-year advance rental.

Subsequently (in the same year the application was filed and the first-year advance rental paid), the taxpayer assigned his rights under the application to a third party for a specified amount, plus an additional amount to be paid to the taxpayer if a lease was issued, with the taxpayer retaining an overriding royalty of 2½ percent. If the application was withdrawn or rejected without the granting of a lease, the advance rental refunded was to be given to the third party.

Section 1.612–3(c)(1) of the Income Tax Regulations defines delay rentals as payments made for the privilege of deferring development of the property that can be avoided by abandonment of the lease, by commencing of development operations, or by obtaining production. If a lessee is committed to make annual payments that cannot be avoided by the abandonment of the lease, by beginning development operations, or by obtaining production, such payments will be regarded as a lease bonus and not a delay rental.

The Supreme Court of the United States, in *E. G. Palmer* v. *A. M. Bender*, 287 U.S. 551 (1933), Ct. D. 641, C.B. XII–1, 235 (1933), held "* * * When the two lessees transferred their operating rights to the two oil companies, whether they became technical sublessors or not, they retained, by their stipulation for royalties, an economic interest in the oil, in place, identical with that of a lessor * * *."

Revenue Ruling 56–252, C.B. 1956–1, 210, holds that first-year "rental" payments by lessees of noncompetitive government oil and gas leases are to be treated as ordinary and necessary expenses. However, it should be noted that during the period prior to the granting of a lease, a first-year advance rental payment is a deposit and is not deductible by the applicant in the taxable year paid unless the lease is granted in the same taxable year. In the event a lease is granted, such advance first-year rental is deductible in the taxable year the lease is granted.

If the lease in the instant case is granted by the Bureau of Land Management, the transaction as a whole is a subleasing arrangement because the taxpayer (as assignor and sublessor) retained an economic interest (the 2½ percent overriding royalty) in the lease.

Accordingly, if the lease is granted, the assignment of the filed application with the retention of an overriding royalty gives rise to an economic interest (the overriding royalty). Therefore, it is held that (1) the first-year rental payment made by the taxpayer in the instant case must be capitalized as the cost of the overriding royalty retained and is recoverable through the allowance for depletion, and (2) the amount received from the third party by the taxpayer for the rights under the assignment, and the additional amount to be received from the third party upon the granting of the lease, are bonus payments and are gross income from the property for the taxable year in which received by the taxpayer.

Revenue Ruling 56–252 is amplified.

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26 CFR 1.612–4: Charges to capital and to expense in case of oil and gas wells.

Whether intangible drilling costs incurred in the drilling of water injection wells necessary for waterflooding operations in the case of primary development of an oil property are within the option to be chargeable to capital or to expense. See Rev. Rul. 69–583, page 41.

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26 CFR 1.612–4: Charges to capital and to expenses in case of oil and gas wells.

Whether taxpayer's election under section 612 of the Code changes when filing a consolidated return. See Rev. Rul. 69–590, page 170.

Section 613.—Percentage Depletion

26 CFR 1.613–1 Percentage depletion; general rule.

Amounts received by the owner of a dairy farm from the extraction of sand and gravel. See Rev. Rul. 69–466, page 140.

Section 616.—Development Expenditures

26 CFR 1.616–1: Development expenditures.

Expenditures for sinking and securing a mining shaft that passes through water-bearing limestone rock are development expenditures deductible under section 616 of the Code.

Rev. Rul. 69–540

Advice has been requested whether, under the circumstances described below, amounts spent by a taxpayer in sinking a shaft are development expenditures deductible under section 616 of the Internal Revenue Code of 1954.

The taxpayer has an economic interest in a mineral property. A mineral deposit in the property had been explored, the existence of potash ores or minerals in commercially marketable quantities had been disclosed, and development of a mine on the mineral property had been started. Access to the mineral deposit was to be through a vertical shaft. Information obtained during exploration of the mineral deposit indicated that the shaft would pass through a thick incompetent zone of water-bearing sands, clays, and shales with water pressures up to 800 pounds per square inch.

Sinking of the vertical shaft was begun by using conventional methods. When the shaft reached the incompetent zone, the taxpayer drilled vertical holes around the shaft from the surface to a depth below the incompetent zone. Brine at minus 30 degrees Fahrenheit was circulated through suitable tubing in the drillholes. That procedure resulted in the formation of a solid frozen column of material through which the shaft was sunk.

As the shaft was sunk through the frozen material it was lined with cast iron sections, called tubs, that were placed to form solid rings, one below the other, around the shaft opening. Each tub weighed four tons and nine tubs formed a ring. All joints between the tubs were gasketed with sheet lead and bolted tightly. The tubbing rings were backed-up with 24 inches of concrete poured between the rings of tubs and the frozen walls of the excavated shaft opening. The tubbed interval was sealed at its top and bottom to prevent the shaft from refilling when the material surrounding the shaft was no longer frozen. Once the tubbing was installed and cemented in place, it was impossible to salvage it.

The formations below the tubbed interval, through which the shaft passes, are water-bearing limestone rock. Although wet, the rock of these formations is stable and the water was controlled by "grouting" in advance of shaft sinking. Pilot holes were drilled into the shaft bottom until water was encountered. Grout, a mixture of cement and water, was pumped down the pilot holes and into the water channels in the rock. When the cement hardened the water was sealed off from a section of rock below the shaft and the shaft was sunk further until more water was encountered. The grouting procedure was then repeated for another section. The shaft, as excavated, was lined with concrete.

An election to treat development expenditures as deferred expenses pursuant to section 616 of the Code was not made by the taxpayer in the instant case.

Section 167(a) of the Code provides that a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in a trade or business or of property held by a taxpayer for the production of income shall be allowed as a depreciation deduction.

Section 616(a) of the Code provides, in part, that a taxpayer is allowed as a deduction in computing taxable income all expenditures paid or incurred during the taxable year for the development of a mine or other natural deposit (other than an oil or gas well) if paid or incurred after the existence of ores or minerals in commercially marketable quantities has been disclosed. This section is not applicable to expenditures for the acquisition or improvement of property of a character that is subject to the allowances for depreciation provided in section 167 of the Code.

The criteria for determining development expenditures that are deductible under section 616 of the Code and section 1.616–1 of the regulations are: (1) the mine must be in the development stage, (2) the expenditures must be for preparing a mineral deposit for extraction of the mineral, and (3) the expenditures must not be for equipment or facilities to extract the mineral from the mine or deposit.

In general, the stages in bringing a mine into production are exploration, development, and production. Preparation of a mine or deposit for extraction of mineral includes development openings (for example tunnels, drifts, shafts, slopes, and pits) that enable the miner to reach the ore and remove it from the natural deposit. However, equipment and facilities, including the cost of their installation, that are used for removal of ore from a mine through the development openings, are generally of a character that is subject to the allowance for depreciation provided under section 167 of the Code. The distinction is whether the expenditure is a development expenditure not subject to depreciation or is made for equipment or facilities to extract the mineral from the mine or deposit.

The expenditures in the instant case are so inextricably related to the mineral in place that except for section 616 of the Code they would be a part of the depletable basis of the property; therefore, they are not recoverable through depreciation.

Accordingly, in the instant case it is held that the expenditures made during the development stage for sinking the shaft, including the expenditures for freezing the earth in the shaft area, the expenditures for tubbing (including its installation and cementing in place), the expenditures for grouting to seal off the water encroachment in the shaft, and the expenditures for the

cement shaft lining are deductible by the taxpayer, under section 616 of the Code, for the taxable year within which they are paid or incurred. However, expenditures made for equipment, facilities, or their installation so that the mineral may be transported through the shaft are for property of a character that is subject to the allowances for depreciation and is recoverable under section 167 of the Code through allowances for depreciation.

Subchapter J. Estates, Trusts, Beneficiaries, and Decedents

Part I. Estates, Trusts, and Beneficiaries

Subpart C. Estates and Trusts Which May Accumulate Income or Which Distribute Corpus

Section 661.—Deduction for Estates and Trusts Accumulating Income or Distributing Corpus

26 CFR 1.661(a)–2: Deduction for distributions to beneficiaries.

The purchase and distribution by an executor of a non-refundable annuity in lieu of a monthly payment for life as provided under a will is treated as a distribution of cash for purposes of section 661 of the Code.

Rev. Rul. 69–432

Under the terms of a decedent's will, the beneficiary was to receive from the estate 350*x* dollars a month during his lifetime. The amount of monthly payments to be made to the beneficiary is not a specific bequest. See section 1.663(a)–1(b)(2) of the Income Tax Regulations. In order to conclude the administration of the estate and make a final distribution to the residuary beneficiaries, the executors, with the beneficiary's approval, purchased and distributed to the beneficiary a non-refundable annuity guaranteed to pay him 350*x* dollars a month during his lifetime. The distribution of the annuity was in full satisfaction of the beneficiary's rights under the will.

Held, the transaction is treated as though the executor had distributed an amount of cash equal to the cost of the annuity, and the beneficiary had purchased the annuity for cash. A deduction is allowable to the estate under section 661(a) of the Internal Revenue Code of 1954, limited by the distributable net income of the estate, and the beneficiary must report a like amount in gross income under section 662(a) of the Code. Further, the basis of the annuity in the hands of the beneficiary is the cost as provided in section 1012 of the Code.

Subchapter L. Insurance Companies

Part I—Life Insurance Companies

Subpart B—Investment Income

Section 804.—Taxable Investment Income

26 CFR 1.804–4: Investment yield of a life insurance company.

Whether charitable contributions may be considered general expense allocable in part to investment expenses. See Rev. Rul. 69–609, page 146.

Section 805.—Policy and Other Contract Liability Requirements

26 CFR 1.805–7: Pension plan reserves.

Reserves maintained under group permanent and individual retirement contracts issued to qualified employees' trusts, annuity plans, and certain exempt organizations by insurance companies do not fail to qualify as "pension plan reserves" merely because such contracts include incidental elements of life insurance.

Rev. Rul. 69–589

Advice has been requested whether reserves maintained under group permanent contracts and individual retirement income contracts as described below qualify as pension plan reserves under section 805(d) of the Internal Revenue Code of 1954.

A life insurance company, taxable under section 802 of the Code, issues group permanent and individual retirement contracts to trusts, plans, and certain organizations referred to in section 805(d)(1) (A), (B), or (D) of the Code. Under these contracts the company provides retirement benefits for the employees covered under the contracts and in addition, provides incidental life insurance benefits during the period prior to retirement. Since these contracts give rise to reserves that include an element of life insurance, the question has arisen whether the portions of the reserves allocable to the life insurance risk qualify as pension plan reserves.

For purposes of computing "taxable investment income" of a life insurance company, section 805(a) of the Code provides, in part, that the term "policy and other contract liability requirements" includes the mean of the "pension plan reserves" at the beginning and end of the taxable year multiplied by the current earnings rate.

Section 805(d)(1) of the Code defines, in pertinent part, "pension plan reserves" as meaning that portion of the life insurance reserves which is allocable to contracts (1) purchased under contracts entered into with trusts which (as of the time the contracts were entered into) were deemed to be exempt employees' trusts described in section 401(a) of the Code; (2) purchased under contracts entered into under plans which (as of the time the contracts entered into) were deemed to be plans described in section 403(a) of the Code (relating to qualified annuity plan); and (3) purchased to provide retirement annuities for its employees by an organization which (as of the time the contracts were purchased) was an exempt organization described in section 501(c)(3) of the Code or purchased to provide retirement annuities for employees who perform services for a public educational institution.

For purposes of computing "gain and loss from operations" of a life insurance company, section 1.809–2(d) of the regulations provides, in effect, that "required interest" for the taxable year with respect to "pension plan reserves" shall be the rate used in computing the reserves, i.e. the current earnings rate.

Senate Report No. 291, Eighty-sixth Congress, C.B. 1959–2, 770, at 781, reads, as follows:

> The amount set aside and not taken into account with respect to pension plans is substantially the same as under the House Bill. * * * The set-aside of this amount * * * is designed to remove discrimination against pension plans of small employers who are likely to be insured through insurance companies. At the present time where an employer is large enough to establish a trusteed pension plan, entirely separate from the insurance company, investment income received by such a trust * * * is free of income tax. *Not taxing investment income attributable to qualified pension plan reserves, therefore, equates with this the treatment provided the smaller employers who establish plans through insurance companies* because they cannot afford to establish separate trusteed pension plans. (Italics added.)

Both section 1.401–1(b)(1)(i) of the Income Tax Regulations (relating to qualified pension plans) and section 1.403(a)–1(d) of the regulations (relating to qualified annuity plans) indicate that the payment of incidental death benefits under qualified trusteed plans is permissible.

In view of the fact that trusteed pension plans may furnish incidental life insurance benefits without affecting their qualification, section 805(d)(1) of the Code would likewise apply to contracts under qualified plans that give rise to reserves that include an incidental element of life insurance, if the full intent set forth in the Committee Reports as to the reason such section was enacted is to be taken into account.

Also, section 1.805–7 of the regulations provides that an adjustment as required by section 818(c) of the Code (relating to an election with respect to life insurance reserves computed on a preliminary term basis) applies to life insurance reserves that satisfy the definition of pension plan reserves in section 805(d)(1) of the Code. Since the section 818(c) adjustment can only apply to reserves on contracts which involves an element of life insurance, section 805(d)(1) of the Code can encompass reserves on contracts under qualified plans that include an element of life insurance.

It is held that the reserves held with respect to the group permanent and individual retirement contracts issued by the taxpayer as described above do not fail to qualify as "pension plan reserves" as defined in section 805(d)(1) of the Code merely because the contracts include an incidental element of life insurance.

Section 806.—Certain Changes in Reserves and Assets

26 CFR 1.806–4: Change of basis is computing reserves.
(Also Section 810; 1.810–3.)

An increase in reserves solely because a life insurance company increased benefits under existing policies is not attributable to a change of basis for computing reserves within the meaning of sections 806(b) and 810(d) of the Code.

Rev. Rul. 69–444

Advice has been requested whether an increase in reserves due to the addition of benefits during the taxable year under existing insurance policies is attributable to a change of basis in computing reserves within the meaning of sections 806(b) and 810(d) of the Internal Revenue Code of 1954.

In 1966 the taxpayer, a life insurance company taxable under section 802 of the Code, announced to certain of its policyholders that their policies would, at no increase in premium, henceforth carry an additional indemnity benefit should death result from a non-occupational vehicular accident. At the end of 1966 the taxpayer, in order to provide for the new contractual obligation, established out of surplus a reserve in an amount equal to the present value of the future unaccrued obligation. The total reserves attributable to each such policy were less than the gross contract premium.

Section 806(b) of the Code provides that if the basis for determining the amount of any item referred to in section 810(c) of the Code as of the close of the taxable year differs from the basis for such determination as of the beginning of the taxable year, then for purposes of determining taxable investment income under subpart B, part 1, of subchapter L, chapter 1 of the Code the amount of such item (1) as of the close of the taxable year shall be computed on the old basis, and (2) as of the beginning of the next taxable year shall be computed on the new basis.

Section 810(d)(1) of the Code provides, in pertinent part, that if the basis for determining any item referred to in subsection (c) as of the close of any taxable year differs from the basis for such determination as of the close of the preceding taxable year, and the amount of the item at the close of the taxable year, computed on the new basis, exceeds the amount of the item at the close of the taxable year, computed on the old basis, then so much of such excess as is attributable to contracts issued before the taxable year shall be taken into account for purposes of subpart C, part 1, subchapter L of the Code over the succeeding 10 taxable years, as a net increase to which section 809(d)(2) of the Code applies.

Sections 806(b) and 810(d) of the Code are applicable only if the basis for determining the amount of "any item" referred to in section 810(c) of the Code as of the close of the taxable year differs, in the case of section 806(b) of the Code, from the basis for such determination as of the beginning of the taxable year and, in the case of section 810(d) of the Code, from the basis for such determination as of the close of the preceding taxable year.

Section 1.801–5(c) of the Income Tax Regulations concerning the definition of total reserves requires detailed information to be filed with respect to all changes in basis for determining the amount of the life insurance reserves including, among other things, the mortality or morbidity tables, assumed rate of interest, method used in computing or estimating the reserve, and the amount of such reserve at the beginning and close of the taxable year

computed on the old basis; and the mortality or morbidity table, assumed rate of interest, method used in computing the reserve and the amount of such reserve at the close of the taxable year computed on the new basis.

In the instant case, the additional indemnity benefit, although payable only as the result of a particular type of accidental death of the insured, is nevertheless insurance on life. Therefore the reserve established to provide for such additional benefit is a life insurance reserve (assuming it meets the definition therefor set forth in section 801(b) of the Code) and constitutes one of the items referred to in section 810(c) of the Code.

Since the new life benefit did not exist before the announcement that made the company contractually liable therefor, there was no reserve attributable to such benefit prior to the end of the taxable year in which the benefit was announced. In this respect the new reserve is similar to a reserve established at the end of the taxable year for any new business coming on the books during the taxable year. A life insurance reserve established at the end of the taxable year attributable to new policies sold during the taxable year has no effect on mortality tables, rates of interest, or actuarial assumptions upon which existing life insurance reserves are based and, therefore, does not constitute a change in basis with respect to items that did not exist at the beginning of the taxable year or the close of the preceding taxable year.

Similarly, a new life insurance reserve attributable to new life benefits for which the company was not contractually liable at the beginning of the taxable year likewise does not constitute a change in basis since it does not affect actuarial assumptions on which the life insurance reserves attributable to existing policies are predicated even though such new benefits are made a part of policies in force at the beginning of the taxable year.

Accordingly, the increase in reserves to provide solely for the additional contractual obligation of the taxpayer pursuant to announced additional benefits during the taxable year under existing policies is not attributable to a change of basis in computing reserves within the meaning of sections 806(b) and 810(d) of the Code.

Subpart C—Gain and Loss from Operations

Section 809.—In General

26 CFR 1.809–5: Deductions.
(Also Section 804; 1.804–4.)

Charitable contributions are deductible by a life insurance company in determining gain or loss from operations, but not in determining taxable investment income.

Rev. Rul. 69–609

During the taxable year, the taxpayer, a life insurance company taxable under section 802 of the Internal Revenue Code of 1954, made charitable contributions as defined in section 170(c) of the Code.

Held, charitable contributions are deductible as such by the taxpayer only in determining gain or loss from operations under section 809(d)(12) of the Code as modified by section 809(e)(3) of the Code. Charitable contributions are not included among the deductions authorized under section 804(c) of the Code in determining investment yield nor are they considered as a general expense allocable in part to investment expenses under section 804(c)(1) of the Code since they are not ordinary and necessary expenses within the meaning of section 162 of the Code. See section 1.804–4(a) of the Income Tax Regulations; *Jefferson Standard Life Insurance Co.* v. *United States* 408 F. 2d 842 (1969), certiorari denied.

Section 810.—Rules for Certain Reserves

26 CFR 1.810–3: Adjustment for change in computing reserves.

Whether an increase in reserves, made necessary because a life insurance company increased benefits under existing policies results in a change of basis in computing reserves within the meaning of section 810(d) of the Code. See Rev. Rul. 69–444, page 145.

Subpart E—Miscellaneous Provisions

Section 817.—Rules Relating to Certain Gains and Losses

26 CFR 1.817–4: Special rules.

The consideration paid by a life insurance company under an assumption reinsurance agreement in acquiring cancellable accident and health contracts may not be treated as deferred expense amortizable over the reasonably estimated life of such contracts.

Rev. Rul. 69–375

Advice has been requested whether the consideration paid by a life insurance company in acquiring a block of cancellable accident and health policies under an assumption reinsurance agreement may be treated as a deferred expense under section 1.817–4(d) of the Income Tax Regulations that may be amortized over the reasonably estimated life of such contracts.

Under an assumption reinsurance agreement effective December 31, 1967, *X* life insurance company ceded to *Y* life insurance company all of its cancellable accident and health policies in force. Pursuant to such agreement, *Y* became solely liable to the policyholders on the policies assumed, and the relationship between *X* (the original insurer) and the policyholders was terminated. On the policies transferred to *Y* there were unearned premiums of 20*x* dollars at December 31, 1967. The purchase price (consideration) paid by *Y* to *X* was three times the unearned premiums. Both *X* and *Y* are taxable as life insurance companies for Federal income taxes under Part I of Subchapter L of the Internal Revenue Code of 1954.

Generally, cancellable health and accident contracts are issued for a period of 12 months or less. Moreover, the insurer is not under an obligation to renew or continue the policy at specified premiums as is the case with long term life insurance or noncancellable

health and accident insurance contracts or as in the case of guaranteed renewable health and accident insurance contracts where the premium may be adjusted but only by classes. Unlike life insurance, noncancellable health and accident, or guaranteed renewable health and accident insurance, cancellable contracts give the insurer the right, in its uncontrolled discretion, to raise the premium rates on individual policies, to alter the scope of the coverage, or to cancel the contract. Thus, not being long term contracts, nothing more than unearned premiums were maintained by *X* with respect to the contracts reinsured.

Section 1.817–4(d) of the Income Tax Regulations provides in pertinent part that:

"(1) For any taxable year beginning after December 31, 1958, the reinsurance of all or a part of the insurance contracts of a particular type by a life insurance company * * *, whereby the reinsuring company or companies assume all liabilities under such contracts, shall not be treated as the sale or exchange of a capital asset but shall be subject to the provisions of sections 806(a) and 809 and the regulations thereunder. * * *

"(2) * * *

"(ii) In connection with assumption reinsurance * * *, a reinsurer shall in any taxable year beginning after December 31, 1957—

* * * * *

"(b) Treat any amount paid to the reinsured, to the extent such amount meets the requirements of section 162, as a deferred expense under section 809(d)(12) and amortize such amount over the reasonably estimated life * * * of the contracts reinsured * * *.

"(iii) For purposes of this subparagraph, the term 'reasonably estimated life' means the period during which the contract remains in force. Such period shall be based on the facts in each case (such as age, health, and sex of the insured, type of contract reinsured, etc.) and the assuming company's experience (such as mortality, lapse rate, etc.) with similar risks."

The above regulations are applicable in the situation of the acquisition of long term contracts. The particular types of contracts referred to are those which necessitate the maintenance of life insurance reserves for which adjustment must be made, together with adjustment of the assets, under section 806(a) of the Code. Such contracts can be subject to a "reasonably estimated life" as defined because they have a life longer than one year and the acquiring company's experience with regard to mortality, lapse rates, etc. is meaningful. That is not the case, however, in the assumption of cancellable health and accident where the acquiring insurance company "* * * could cancel high risk policies, which would cause a high termination rate in early years followed by a low termination rate in later years. In addition, changes in the rate structure and coverage, if atypical of action by the insurance industry generally, would have a substantial impact on lapse rates. * * * reflects perhaps an inherent obstacle to the amortization of cancellable health and accident policies." *International Life Insurance Co.*, 51 T.C. 765, 774. See also Rev. Rul. 65–175, C.B. 1965–2, 41.

In considering the particular type of contract subject to assumption reinsurance, there is no reason why there would be any different result simply because cancellable health and accident contracts are acquired by a life insurance company subject to tax imposed by section 802 of the Code rather than by an insurance company subject to tax imposed by section 831 of the Code.

Accordingly, it is held that the consideration paid by *Y* to acquire cancellable acident and health contracts may not be treated as a deferred expense under section 1.817–4(d) of the regulations that may be amortized over the reasonably estimated life of such contracts. Such expenditure represents the cost of acquiring an intangible asset having an indeterminate useful life.

Section 818.—Accounting Provisions

26 CFR 1.818–5: Short taxable years.

Whether insurance companies are required to file one or two income tax returns when they have certain changes in the nature of their insurance business during the calendar year. See Rev. Rul. 69–405, page 240.

Part II—Mutual Insurance Companies (Other Than Life and Certain Marine Insurance Companies and Other Than Fire or Flood Insurance Companies Which Operate on Basis of Perpetual Policies or Premium Deposits)

Section 825.—Unused Loss Deduction

26 CFR 1.825–1: Unused loss deduction; in general.

Applicability of the provisions of section 6411 of the Code for a tentative carryback adjustment in the case of mutual casualty insurance companies. See Rev. Rul. 69–660. page 259.

Subchapter M. Regulated Investment Companies and Real Estate Investment Trusts

Part I—Regulated Investment Companies

Section 852.—Taxation of Regulated Investment Companies and Their Shareholders

26 CFR 1.852–3: Investment company taxable income.

Treatment of dividends declared and paid to an independent trustee by a regulated investment company prior to a statutory merger on December 31, 1968, for distribution to its cash basis shareholders on the January 15, 1969, payment date.

Rev. Rul. 69–652

Advice has been requested concerning the Federal income tax treatment of dividends declared by the acquired corporation in a statutory merger of two regulated investment companies under the circumstances described below.

Corporations *X* and *Y* were closed-end diversified investment companies subject to tax as regulated investment

companies under subchapter M (Part I) of chapter 1 of the Internal Revenue Code of 1954. *X* owned approximately 75 percent of the outstanding shares of *Y*. On December 31, 1968, *Y* was merged into *X* pursuant to State law.

Prior to the date of the merger, *Y* declared a dividend, payable January 15, 1969, to its shareholders of record on December 31, 1968, the close of its taxable year. All of *Y*'s shareholders employ the cash receipts and disbursements method of accounting. Immediately prior to the December 31 merger, *Y* paid to an independent trustee for the benefit of its shareholders the full amount of the dividend that was payable January 15, 1969. Under this arrangement, the earnings of *Y* for 1968 were paid out to the trustee for the benefit of the shareholders of *Y* prior to the merger so that, except to the extent that the estimate of earnings declared as a dividend in December differed from actual earnings, none of the earnings of *Y* passed over to *X*.

Section 852(b)(2)(D) and section 852(b)(3)(A)(ii) of the Internal Revenue Code of 1954, respectively, provide for the deduction for dividends paid (as defined in section 561 of the Code) with respect to ordinary and capital gain dividends of a regulated investment company. Section 561(a) of the Code provides, in part, that the deduction for dividends paid shall be the sum of the dividends paid during the taxable year.

Section 855(a) of the Code provides that if a regulated investment company declares a dividend prior to the time prescribed by law for the filing of its return for a taxable year and distributes the amount of such dividend to shareholders in the 12-month period following the close of such taxable year and not later than the date of the first regular dividend payment made after such declaration, the amount so declared and distributed shall, to the extent the company elects in such return, be considered as having been paid during such taxable year. *Y* made a valid election in the return filed by the company for the taxable year 1968 to have the dividend declared in 1968 considered as having been paid during its taxable year 1968.

Section 855(b) of the Code provides that amounts to which section 855(a) is applicable shall be treated as received by the shareholder in the taxable year in which the distribution is made.

Accordingly, it is held that under the circumstances described *Y* is entitled to a dividends paid deduction under section 852 of the Code provided it meets all the other requirements of subchapter M of Chapter 1 of the Code.

It is further held that the dividend is includible in the gross income of the shareholders of *Y* in 1969, the taxable year in which the distribution was made by the trustee.

Section 855.—Dividends Paid by Regulated Investment Company After Close of Taxable Year

26 CFR 1.855–1: Dividends paid by regulated investment company after close of taxable year.

A dividend distributed in three installments after the close of the taxable year may be treated as a distribution for the prior year where a regulated investment company elected such treatment in its return for the prior year.

Rev. Rul. 69–445

Advice has been requested whether a dividend distributed in three installments by a regulated investment company during the 12-month period after the close of its taxable year 1968 will be considered as having been paid during 1968 under the circumstances described below.

The taxpayer, a regulated investment company as defined in section 851 of the Internal Revenue Code of 1954, has in the past distributed all of its investment company taxable income and net long-term capital gains received each year. With respect to the latest year, 1968, the taxpayer made three distributions in 1969 of income and capital gains received in 1968. Such distributions occurred in the following order and on three different payment dates: a dividend from 1968 net investment company taxable income, a dividend from 1968 net realized capital gains, and a further dividend from 1968 net investment company taxable income. All of these dividends were declared by the taxpayer before the time prescribed by law for filing its 1968 Federal income tax return and were distributed during 1969 before the taxpayer's first distribution of 1969 earnings. In its 1968 Federal income tax return, the taxpayer elected in accordance with section 1.855–1(b) of the Income Tax Regulations to treat these three dividend distributions in 1969 as having been paid in 1968.

Section 855(a) of the Code provides that if a regulated investment company declares a dividend before the time prescribed by law for the filing of its return for the taxable year and distributes the amount of such dividend to its shareholders in the 12-month period following the close of such taxable year and not later than the date of the first regular dividend payment made after such declaration, the amount so declared and distributed shall, to the extent the company elects in such return in accordance with the regulations prescribed by the Secretary or his delegate (section 1.855–1(b) of the regulations), be considered as having been paid during such taxable year.

Under this section of the Code, it is necessary in resolving the question presented to consider whether any one of the three distributions is "the first regular dividend payment" made after the declaration.

Inasmuch as the three distributions described above were made from income and gains received in 1968 and were made no later than the first distribution from the income and gains of 1969, it is held that none of the distributions are "the first regular dividend payment" made after such declaration.

Accordingly, the distributions made in three installments by the taxpayer in 1969, pursuant to its election made in its 1968 return, qualify under section 855(a) of the Code as dividends paid in 1968. See Revenue Ruling 64–30, C.B. 1964–1 (Part 1), 232, which holds similarly with respect to distributions made by a real estate investment trust under section 858 of the Code.

Part II—Real Estate Investment Trusts

Section 856.—Definition of Real Estate Investment Trust

26 CFR 1.856–1: Definition of real estate investment trust.

The issuance of a second class of shares of beneficial interest does not prevent a trust from continuing to qualify as a real estate investment trust under section 856 of the Code.

Rev. Rul. 69–610

An unincorporated trust that qualified as a real estate investment trust as defined in section 856 of the Internal Revenue Code of 1954 issued a second class of shares of beneficial interest that gave the beneficial owners a preference as to dividends and a preference on liquidation.

Held, the issuance of the second class of shares of beneficial interest does not in and of itself prevent the trust from continuing to qualify as a real estate investment trust under section 856 of the Code.

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

Federal income tax and interest equalization tax consequences of an "overseas financing" arrangement. See Rev. Rul. 69–377, page 231.

26 CFR 1.861–4: Compensation for labor or personal services.

When a nonresident alien temporarily employed in the United States by a foreign corporation receives compensation for personal services in excess of $3,000, the entire amount is income from sources within the United States.

Rev. Rul. 69–479

Advice has been requested concerning the application of section 861(a)(3)(B) of the Internal Revenue Code of 1954 under the circumstances described below.

X, a nonresident alien individual received $3,500 from his employer, a foreign corporation not engaged in a trade or business within the United States, for personal services performed by him while temporarily present in the United States for a period of 89 days during the taxable year 1968.

Section 861(a) of the Code provides, in general, that certain items of gross income shall be treated as income from sources within the United States. Section 861(a)(3) of the Code provides, in pertinent part, as follows:

"(3) Personal services.—Compensation for labor or personal services performed in the United States; except that compensation for labor or services performed in the United States shall not be deemed to be income from sources within the United States if—

"(A) the labor or services are performed by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year,

"(B) such compensation does not exceed $3,000 in the aggregate, and

"(C) the compensation is for labor or services performed as an employee of or under a contract with—

"(i) a nonresident alien, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, or

"(ii) an individual who is a citizen or resident of the United States, a domestic partnership, or a domestic corporation, if such labor or services are performed for an office or place of business maintained in a foreign country or in a possession of the United States by such individual, partnership, or corporation."

The $3,000 specified in section 861(a)(3)(B) of the Code is a limitation upon the "aggregate" amount of compensation for labor or personal services performed by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding 90 days during the taxable year in determining whether the requirements of section 861(a)(3) of the Code are met. Where the "aggregate" amount of compensation earned exceeds $3,000, the specific requirement of section 861(a)(3)(B) of the Code has not been satisfied.

Accordingly, since *X* earned more than $3,000 in a taxable year as compensation for personal services, all of the amount so received is income from sources within the United States under the provisions of section 861(a)(3) of the Code.

Section 862.—Income From Sources Without the United States

26 CFR 1.862–1: Income specifically from sources without the United States.

Federal income tax and interest equalization tax consequences of an "overseas financing" arrangement. See Rev. Rul. 69–377, page 231.

Section 864.—Definitions

Federal income tax and interest equalization tax consequences of an "overseas financing" arrangement. See Rev. Rul. 69–377, page 231.

Part II—Nonresident Aliens and Foreign Corporations

Subpart A—Nonresident alien individuals

Section 871.—Tax on Nonresident Alien Individuals

26 CFR 1.871–1: Taxation of aliens.

Whether appointing of a United States agent by a nonresident alien prevents withholding of tax. See Rev. Rul. 69–655, page 168.

26 CFR 1.871–2: Determining residence of alien individuals.

The members of families of foreign ambassadors and ministers are

nonresident aliens for income tax purposes; O.D. 198 superseded.

Rev. Rul. 69–517 [1]

The members of families of foreign ambassadors and ministers occupy the status of nonresident aliens for income tax purposes. See *Joseph Van Der Elst* v. *Commissioner,* 223 F. 2d 771 (1955).

O.D. 198, C.B. 1, 164 (1919), is hereby superseded, since the position stated therein is set forth under the current statute and regulations in this Revenue Ruling.

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26 CFR 1.871–2: Determining residence of alien individuals.

A year's presence in the United States by an alien raises a presumption of residence that may be rebutted by any proper evidence; O.D. 197 superseded.

Rev. Rul. 69–611 [1]

If an alien has been residing in the United States for as much as one year there is a presumption that such alien is a resident of the United States for the purposes of Federal income taxes in the absence of known facts showing that the alien is, in fact, a transient. A year's presence in the United States by an alien does not, however, establish residence beyond a doubt. It merely raises a presumption of residence that may be rebutted by any proper evidence showing that the alien is, in fact, a transient, that is, a nonresident. See section 1.871–2(b) of the Income Tax Regulations that defines residence.

O.D. 197, C.B. 1, 164 (1919), is hereby superseded, since the position stated there is set forth under the current statute and regulations in this Revenue Ruling.

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26 CFR 1.871–3: Residence of alien seamen.

The term "foreign trade" as used in section 1.871–3 of the Income Tax Regulations is defined; O.D. 315 superseded.

Rev. Rul. 69–565 [1]

The term "foreign trade" as used in section 1.871–3 of the Income Tax Regulations includes the transportation upon the high seas of passengers and freight between the United States and foreign countries.

O.D. 315, C.B. 1, 164 (1919), is hereby superseded, since the position stated therein is set forth under the current statute and regulations in this Revenue Ruling.

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.
(Also Section 902; 1.902–3.)

Swiss National Defense Tax, Stamp Duties Tax, and Federal Withholding Tax are income taxes allowable as a credit against United States income tax.

Rev. Rul. 69–446

Article 48 of Swiss Federal Decree of December 9, 1940, as amended, relating to the National Defense Tax (Wehrsteuer), imposes a tax upon the taxable income of Swiss corporations and other entities. Such income is computed in a manner similar to the computation of taxable income for United States Federal income tax purposes.

Article 3 of Swiss Federal Decree of October 4, 1917, as amended, relating to the Stamp Duties Tax (Couponsabgabe), and Article 4 of the Ordinance of the Swiss Federal Council of September 1, 1943, as amended, relating to the Federal Withholding Tax (Verrechnungsteuer), impose taxes upon considerations of money value (other than a return of capital) granted by Swiss corporations to their shareholders in the form of interest, annuities, profits and other considerations. These taxes are imposed upon the shareholder receiving the consideration and are withheld by the grantor corporation. Such taxes are similar to the United States income tax imposed on dividends, interest, and compensation received from sources within the United States by nonresident aliens and foreign corporations under sections 871 and 881 of the Internal Revenue Code of 1954, as implemented by withholding under sections 1441 and 1442 of the Code.

Held, the above described taxes are income taxes with the meaning of the United States concept of that term and are creditable taxes under sections 901 and 902 of the Code subject to the limitations of section 904 of the Code. The Stamp Duties Tax (Couponsabgabe) is computed on the basis of economic gain realized and is not an excise tax within the meaning of the United States concept of an excise tax.

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26 CFR 1.901–1: Allowance of credit for taxes.

Treatment of the Greek tax on distributions to shareholders out of current and accumulated income of Greek corporations for purposes of the foreign tax credit under section 901 of the Code.

Rev. Rul. 69–468

Advice has been requested whether the Greek tax on distributions to shareholders out of current and accumulated net income or profit of Greek corporations is a tax imposed on such shareholders for purposes of section 901 of the Internal Revenue Code of 1954.

Article 4(a) of Legislative Decree 3843/1958 of the Government of Greece imposes a tax on the current net income or profit of Greek corporations, with the exception of that part which is currently distributed to shareholders. Under Article 15(1) of the Decree, a Greek corporation that

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

makes a distribution to its shareholders from current net income or profit is required to withhold the income tax that is in effect imposed on the shareholders under the laws of Greece and to pay over this amount to the Greek Government.

If current net income or profit is not distributed to the shareholders, the Greek corporation is taxed on such amounts. Upon subsequent distribution of these amounts to its shareholders, the Greek corporation, pursuant to Article 15(1) of the Decree, is required to withhold the income tax that is imposed on the shareholders under the laws of Greece. However, under Article 15(3) of the Decree, such tax withheld is reduced by a credit for the tax previously paid by the Greek corporation on these amounts and the corporation reduces the amount of tax that it would otherwise withhold and pay over to the Greek Government by the amount of such credit. If the tax previously paid by the corporation on these amounts exceeds the required withholding, the excess is refunded to the corporation by the Greek Government.

The taxes discussed above with regard to distributions by Greek corporations of current and accumulated net income and profits are creditable taxes under section 901 of the Code which provides, in part, that taxes paid or accrued to any foreign country shall be allowed as a credit against United States income taxes if such tax is a tax on income, war profits or excess profits. However, the credit for taxes paid to a foreign country under section 901 of the Code is allowable only to the taxpayer upon whom the tax is imposed. *Mary D. Biddle, et al.* v. *Commissioner,* 302 U.S. 573 (1938), Ct. D. 1303, C.B. 1938–1, 309.

The Greek tax on distributions from current net income or profits is in effect a tax imposed on the shareholder receiving such distributions. Accordingly, it is held that the tax paid by the shareholders, through withholding, to the Greek Government on distributions of current net income or profits is allowable as a credit against United States taxes of such shareholders in accordance with section 901 of the Code.

Under United States tax concepts the Greek tax on accumulated net income or profit is imposed on and paid by the Greek corporation. Although, under Greek tax concepts, a second tax is in effect imposed on the shareholders on such amounts when they are distributed, to the extent that such shareholder tax is reduced by a credit for the proportionate amount of the tax imposed on and paid by the corporation for United States tax purposes no tax has been imposed on and paid by the shareholder.

Accordingly, it is held that the tax imposed on the corporation on its accumulated net income or profit under Greek tax concepts is not allowable as a credit against United States income taxes of the corporation's shareholders under section 901 of the Code. However, the tax is in effect imposed on the shareholders to the extent it is not reduced by the proportionate amount of the tax previously imposed on and paid by the Greek corporation and is allowable as a credit, under section 901 of the Code, against United States Federal income tax of the shareholders.

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26 CFR 1.901–1: Allowance of credit for taxes.

The Italian Tax on Agricultural Income imposed by Title III of the Consolidated Code of Laws on Direct Taxes does not qualify as an income tax for which a foreign tax credit may be allowed.

Rev. Rul. 69–480

Advice has been requested whether the Italian Tax on Agricultural Income (l'imposta sui redditi agrari) imposed by Title III of the Consolidated Code of Laws on Direct Taxes (Testo Unico Delle Leggi Sulle Imposte Dirette), approved by Presidential Decree No. 645 of January 29, 1958, as supplemented and amended, qualifies as an income tax that may be allowed as a credit against United States income tax under section 901 of the Internal Revenue Code of 1954.

Article 62 of the Consolidated Code of Laws on Direct Taxes (Consolidated Code) defines the scope of the tax as a tax on income from agriculture arising from the carrying on of an agricultural enterprise on land possessed by a real right, of which the taxable income determined under Article 52 of such Code exceeds 600 lire.

Article 52 of the Consolidated Code provides that the taxable income shall be the landowner's portion of the average ordinary income obtainable from the land, net of expenses and losses, and shall be determined by the application of the schedule of estimated value established according to the provisions of the cadastral laws.

Article 64 of the Consolidated Code provides, in part, that there shall apply, for each and every taxation period, only the cadastral registration of the land at August 31 of the preceding year.

Article 65 of the Consolidated Code provides for the determination of agrarian income by applying the schedules of estimated values established in accordance with the provisions of the cadastral law to the individual cadastral particles forming the estate.

Article 66 of the Consolidated Code establishes the rate of tax of 10 lire for each 100 lire of taxable income.

Article 135 of Title VI of the Consolidated Code relating to the analytical computation of aggregate net income provides in paragraph (a) thereof that income from agriculture is assessed as in the cadastral survey multiplied by the co-efficients of variation fixed annually by the tax department in relation to price trends of agricultural products and to the means of production.

Section 901 of the Internal Revenue Code of 1954 allows a credit against the United States tax for foreign income, war profits, and excess profits taxes paid or accrued during the taxable year. In order for a tax paid to a foreign country to qualify as an income tax, however, it must be shown that the tax imposed by the foreign country is a tax on income within the United

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States concept thereof (*Mary D. Biddle* v. *Commissioner,* 302 U.S. 503 (1938), Ct. D. 1303, C.B. 1938–1, 309), or is a tax in lieu of an income tax within the meaning of section 903 of the Code.

Article I (b) of the United States-Italy Income Tax Convention (C.B. 1956–2, 1096), includes within the terms of the convention the Italian tax on agricultural income (l'imposta sui redditi agrari). However, Article XV(1)(a) provides, in pertinent part, that the United States will allow a credit for Italian income taxes subject to the provisions of sections 901 through 905 of the Code. In the Senate Executive Report No. 12, 84th Congress, 1st Session (C.B. 1956–2, 1103), the Joint Committee on Internal Revenue Taxation stated:

> * * * Although the above categories of Italian taxes are included within the terms of the convention, only those taxes which come within section 901 of the 1954 Code are eligible for the credit against the United States income tax provided in sections 901 through 905 of the Code (See Art. XV) * * *.

Agrarian income upon which the 10 percent tax rate is imposed under Article 66 of the Italian Consolidated Code is determined by applying to the individual cadastral particles forming the estate, the schedules of estimated values established in accordance with cadastral law. Webster's New International Dictionary defines "cadastral" as "purpose of making a cadastre." Black's Law Dictionary, Fourth Edition defines "cadastre" as "an official statement of the quantity and value of real property in any district, made for the purpose of justly apportioning the taxes payable on such property."

The Italian tax on agricultural income is based upon estimates of the value of the land as of August 31 of the preceding taxable year depending upon the farming activities or facilities for which it is fit and not on the actual income derived from such activities or facilities. Under the cadastral technique the tax may be assessed whether or not the land is actually farmed.

Accordingly, the Italian tax on agricultural income (l'imposta sui redditi agrari) which is imposed on imputed income amounts ascertained from the cadastral register bears no relation to the actual income or profits derived from farming operation and is not an income tax or a tax paid in lieu of an income tax within the meaning of section 903 of the Code and, therefore, is not a creditable tax under section 901 of the Code.

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26 CFR 1.901–1: Allowance of credit for taxes.

A duty imposed by the Quebec Mining Duties Act is not an income tax allowable as a foreign tax credit under section 901(a) of the Code.

Rev. Rul. 69–653

Advice has been requested whether the duty imposed by Section 4 of the Quebec Mining Duties Act (14 Eliz. II, 1965 C. 35) is an income tax which may be claimed as a credit against United States income tax in accordance with section 901(a) of the Internal Revenue Code of 1954.

Section 4 of the Act provides that every mine in the Province of Quebec, Canada, is subject to mining duties, and that every operator of such a mine shall pay duties on its annual profits as provided in the Act.

Section 7 of the Act provides that the annual profit shall be ascertained by deducting from the gross value of the annual output, the operating expenses of the mine, mill, smelter, and other installations incurred in order to realize such gross value and certain other expenses directly related to the mining operation.

Section 5 of the Act provides that the gross value of the annual output shall be the actual value of mineral substances sold or used by an operator during the year at the market price at the time of the sale or use thereof, or the actual value of mineral substance shipped or used by an operator during the year at the market price at the time of the shipping or use.

Section 901(a) of the Code provides, in general, that subject to the limitations of section 904 of the Code, the taxpayer, if he so chooses, may credit his United States income tax with 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.

A foreign tax will qualify for the credit only if it is a tax on income within the concept of that term as used and recognized in the United States income tax law. *Biddle* v. *Commissioner,* 302 U.S. 573 (1938) Ct. D. 1303, C.B. 1938–1, 309. Whether the duty imposed by the Quebec Mining Duties Act is an income tax within the United States concept of a tax on income depends primarily on the measure of the tax or the tax base. As stated in *Eisner* v. *Macomber,* 252 U.S. 189, at 207 (1919), income may be defined as the gain derived from capital, from labor, or from both combined, provided it be understood to include a profit gained through the sale or conversion of capital assets.

The annual profits upon which the tax in question is imposed is the gross value of the annual output, less certain operating expenses and other expenses of the mine, mill, smelter, or other installation, incurred in order to realize such gross value. The gross value of the annual output may be stated (Section 5 of the Act) as the market value of all substances extracted from the mine whether sold, shipped, or consumed by the operator of the mine. The shipping or consumption by the operator of the mine of the substance extracted from the mine might require imposition of the duty in question even though no income resulted. Since the levy of the tax is independent of the derivation of gain or profit, it does not satisfy the criteria of an income tax as the term is used for United States income tax purposes. See *Keasbey and Mattison Co.* v. *Rothensies,* 133 F. 2d 894 (1943), certiorari denied, 320 U.S. 739.

Accordingly, it is held that the duty imposed by Section 4 of the Quebec Mining Duties Act is not an income tax and may not be claimed as a credit against United States income tax in accordance with section 901(a) of the Internal Revenue Code of 1954.

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26 CFR 1.901–1: Allowance of credit for taxes.

Allowance of credit for income tax paid to the Republic of Indonesia. See Rev. Rul. 69–388, page 154.

Section 902.—Credit for Corporate Stockholder in Foreign Corporation

26 CFR 1.902–3: Credit for domestic corporate shareholder of a foreign corporation (after amendment by Revenue Act of 1962).
(Also Section 934; 1.934–1.)

A subsidy received by a Virgin Islands subsidiary of a United States corporation from the Virgin Islands Industrial Incentive Program is considered a reduction in the amount of taxes paid to the Virgin Islands for purposes of section 902 of the Code.

Rev. Rul. 69–433

A United States corporation has a Virgin Islands subsidiary that satisfies the requirements of Virgin Islands law and the conditions set forth in section 934 of the Internal Revenue Code of 1954. Therefore, the Virgin Islands subsidiary has received, under the Virgin Islands Industrial Incentive Program, a nontaxable subsidy equal to 75 percent of the income tax liability paid to the Virgin Islands during the taxable year.

Held, in computing the accumulated profits of the Virgin Islands subsidiary for purposes of section 902(a)(2) of the Code, the amount of the subsidy is not an item of gains, profits, or income but is considered merely a reduction in the amount of the taxes paid to the Virgin Islands. *Held further,* for purposes of section 902(a)(2) of the Code, the income tax paid by such subsidiary to the Virgin Islands is the amount of income tax paid to the Virgin Islands less the subsidy granted.

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26 CFR 1.902–3: Credit for domestic corporate shareholder of a foreign corporation (after amendment by Revenue Act of 1962).
(Also Section 316; 1.316–2.)

For purposes of the foreign tax credit, dividends paid by a wholly-owned foreign subsidiary after the first 60 days of the taxable year are deemed paid first from current earnings and profits of the year in which the dividends are paid.

Rev. Rul. 69–447

Advice has been requested as to the appropriate year to which dividends are attributable in computing the foreign tax credit pursuant to section 902 of the Internal Revenue Code of 1954. The situation described below illustrates the nature of the question presented.

X, a domestic corporation, received a dividend from *Z,* its wholly-owned foreign subsidiary. *Z* had $365 (one dollar per day) accumulated profits after income tax for a particular taxable year. On the 65th day after the beginning of that taxable year *Z* paid a dividend of $100 to *X.* No other dividends were declared or paid during that year.

The question is whether in computing the foreign tax credit under section 902 of the Code, *X* should treat the dividend paid to it by *Z* after the first 60 days of *Z*'s taxable year by prorating the accumulated profits of the entire year on a daily basis so that *X* could treat $65 (one dollar for each day) as having been paid from *Z*'s accumulated profits of the current year and the excess, $35, as having been paid from *Z*'s accumulated profits of a prior year or years.

Section 902 of the Code provides, generally, that a domestic corporation that owns at least 10 percent of the voting stock of a foreign corporation from which it receives dividends in any taxable year is permitted a credit against United States income tax for the foreign taxes paid by its foreign subsidiary with respect to the dividends distributed from the accumulated profits of the foreign subsidiary.

Section 902(c) of the Code provides, in part, that the Secretary or his delegate shall have full power to determine from the accumulated profits of what year or years such dividends were paid, treating dividends paid in the first 60 days of any year as having been paid from accumulated profits of the preceding year or years, and in other respects treating dividends as having been paid from the most recently accumulated gains, profits, or earnings.

In determining "accumulated profits" for the purpose of computing the foreign tax credit under section 902(a) of the Code, the criteria of section 316 of the Code are applicable. See Rev. Rul. 63–6, C.B. 1963–1, 126.

Section 316 of the Code defines dividends and provides that except as otherwise provided in subtitle A (which includes section 902 of the Code), every distribution is made out of earnings and profits to the extent thereof, and from the most recently accumulated earnings and profits. Section 1.316–2(a) of the Income Tax Regulations provides, in pertinent part, that in determining the source of a distribution, consideration should be given first to the earnings and profits of the taxable year. Thus, it is clear that section 316 of the Code governs the order of distribution of earnings and profits or accumulated profits for the purpose of section 902 of the Code.

The Supreme Court of the United States held, in *Edwards, Collector* v. *Archibald Douglas et al., Executors of James Douglas,* 269 U.S. 204 (1925), T.D. 3797, C.B. V–1, 158 (1926), that the phrase "most recently accumulated undivided profits or surplus" as used in section 31(b) of the Revenue Act of 1916 (now section 316 of the Code) includes current earnings of the year in which the dividends are paid.

Accordingly, in determining the appropriate year to which dividends are

attributable for the purpose of section 902 of the Code, any dividends paid after the first 60 days of the taxable year are deemed paid first out of the current earnings and profits of the year in which the dividends are paid. Thus, in the instant case, the $100 dividend paid by *Z* to *X* is treated as having been paid out of *Z*'s current earnings and profits ($365) for the year in which the dividends are paid.

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26 CFR 1.902–3: Credit for domestic corporate shareholder of a foreign corporation (after amendment by Revenue Act of 1962).

Whether the Swiss National Defense Tax, Stamp Duties Tax, and Federal Withholding Tax are income taxes for the purposes of sections 901 and 902 of the Code. See Rev. Rul. 69–446, page 150.

Section 903.—Credit for Taxes in Lieu of Income, etc., Taxes

26 CFR 1.903–1: Definition of taxes in lieu of income, war profits, or excess profits taxes.
(Also Section 901; 1.901–1.)

Tax paid pursuant to a contract executed under Indonesian Law Number 1 of January 10, 1967, is a tax in lieu of an income tax under section 903 of the Code and is a creditable tax for purposes of the foreign tax credit.

Rev. Rul. 69–388

The Republic of Indonesia by the "Ordinance Indonesian Corporation Tax, 1925," as amended, and its territory of Irian Barat (West Irian) by the "Ordinance for Company Tax, 1925," as amended, impose a general income tax on the income of foreign enterprises operating in Indonesia and West Irian, respectively. Article 17 of Chapter VI of Indonesian Law No. 1 of January 10, 1967, authorizes the Government of Indonesia to grant, by individual contract, certain tax incentives to foreign enterprises investing capital in Indonesia. The contract stipulates a method of computing taxable income and the amount of tax payable, which differs from, and is a substitute for, the taxing provisions of the general income tax laws of Indonesia and its political subdivisions including West Irian. *Held,* tax paid pursuant to a contract executed under the authority of Indonesian Law No. 1 of January 10, 1967, is a tax in lieu of an income tax within the meaning of section 903 of the Internal Revenue Code of 1954 and is creditable against United States income tax under section 901 of the Code subject to the applicable limitations of section 904 of the Code.

Section 904.—Limitation on Credit

26 CFR 1.904–1: Limitation on credit for foreign taxes.
(Also Sections 1502, 1504; 1.1502–4, 1.1504–1.)

A change in election from the overall limitation to the per-country limitation on foreign tax credit may be made by the common parent of an affiliated group filing consolidated returns where it acquires control of another affiliated group with income from another country.

Rev. Rul. 69–518

Corporation *M* and its affiliated group of corporations, within the meaning of section 1504 of the Internal Revenue Code of 1954, made a proper election to file a consolidated return for the taxable year 1967. The affiliated group realized taxable income from foreign countries *X* and *Y* during 1967. *M* as common parent made a timely election to use the overall limitation on foreign tax credit pursuant to the provisions of section 904(a)(2) of the Code for 1967 and subsequent years.

In 1968 *M* acquired control of corporation *O* and its affiliated group of corporations which had substantial business operations in foreign country *Z*. *O* and its affiliated group had filed a consolidated return for 1967 and had used the per-country limitation on foreign tax credit as provided for in section 904(a)(1) of the Code. Neither *M* nor *O* had any foreign tax credit carryovers at the date of acquisition. As a result of the acquisition of *O* and its affiliated group the new affiliated group had income from country *Z* in addition to income from countries *X* and *Y*.

In 1968 *M*, as common parent of the new affiliated group filing a consolidated return, requested permission to revoke the election of the overall limitation for the taxable year 1968 and to use the per-country limitation as provided for by section 904(a)(1) of the Code on the ground that by acquiring *O* and its affiliated group of corporations it had entered into substantial business operations in a new country within the meaning of section 1.904–1(d)(3) of the Income Tax Regulations.

Held, under the circumstances, *M*, as common parent of the new affiliated group filing a consolidated return, is considered to have entered into substantial business operations in a new country (*Z*) within the meaning of section 1.904–1(d)(3) of the regulations for the purpose of changing the election from the overall limitation to the per-country limitation on foreign tax credit.

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.

Amounts paid to a United States citizen as compensation for services by a Federal credit union in a foreign country may be excludable from gross income under section 911 of the Code.

Rev. Rul. 69–448

The taxpayer, a citizen of the United States, during a period of 18 consecutive months was present in a foreign

country during at least 510 full days as an employee of a Federal credit union. He was employed at the credit union's sub-office located in the foreign country. The credit union was organized in accordance with provisions of the Federal Credit Union Act, as amended, 12 U.S.C. 1751 et seq. Under that Act it is empowered to carry on business as a private institution in promoting thrift among its members and creating a source of credit for its members. Its employees are paid from the income generated by its business operations.

Section 911 of the Internal Revenue Code of 1954, relating to the exemption from tax for earned income received by a United States citizen while residing outside the United States does not exempt from Federal income tax amounts paid by the United States or any agency thereof.

Held, since the Federal credit union is not an agency of the United States amounts paid by it to the taxpayer as compensation for his services are not "amounts paid by the United States or an agency thereof" within the meaning of section 911(a) of the Code and, therefore, the taxpayer may exclude his salary from gross income pursuant to section 911 of the Code subject to the limitations thereof.

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26 CFR 1.911–2: Earned income from sources without the United States attributable to services performed after 1962.

The exemption provided by section 911(a)(1) of the Code does not apply to income earned by United States citizens who enter Viet Nam under the Multilateral-Mutual Defense Assistance in Indochina Agreement between the United States and the Republic of Viet Nam.

Rev. Rul. 69–449

Advice has been requested concerning the exemption from gross income provided by section 911(a)(1) of the Internal Revenue Code of 1954, under the circumstances described below.

The taxpayer, a United States citizen, was employed by a United States employer under contract with the United States Armed Forces. He entered the Republic of Viet-Nam and established his status under the Multilateral Mutual Defense Assistance in Indochina Agreement ("Pentalateral Agreement") of December 23, 1950. Treaties and other International Act Series No. 2447. The taxpayer was employed in the Republic of Viet-Nam for thirteen months and then returned to the United States.

Under Annex B of the Pentalateral Agreement certain United States citizens present in the Republic of Viet-Nam are granted certain privileges and immunities from the local jurisdiction. One of the immunities specified for such persons is exemption from internal taxation by the Republic of Viet-Nam upon salaries of such personnel. The exemption is based upon the rationale that under these circumstances the United States citizen does not become a permanent resident or domiciliary of the Republic of Viet-Nam. See Rev. Rul. 68–553, C.B. 1968–2, 311.

Subject to specified conditions and limitations, section 911(a)(1) of the Code provides for the exemption from United States income tax of earned income from sources without the United States for an individual citizen who qualifies as a bona fide resident of a foreign country or countries.

Section 911(c)(6) of the Code provides that, if an individual United States citizen who has earned income from sources within a foreign country makes a statement to the authorities of such country that he is not a resident of that country and is held not subject to the income tax of that country by its authorities with respect to such earnings, he is not a bona fide resident of that country for the purposes of section 911(a)(1) of the Code.

In the instant case, the status of being exempt from the income tax of the foreign country as a nonresident of the foreign country under the Multilateral-Mutual Defense Assistance In Indochina Agreement is considered to be the equivalent of the "statement" referred to in section 911(c)(6) of the Code. Thus, the United States citizen is not considered a bona fide resident of the Republic of Viet-Nam for purposes of section 911(a)(1) of the Code.

Accordingly, the exemption provided by section 911(a)(1) of the Code is not applicable to income earned by the taxpayer in the Republic of Viet-Nam from work that he was admitted to perform, since he has qualified under the Agreement.

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.

Interest on a refund resulting from a section 482 allocation of income and deductions between a subsidiary and its parent is not taken into account in determining qualification as a Western Hemisphere trade corporation or in computing the section 922 deduction.

Rev. Rul. 69–376

A domestic subsidiary corporation qualified as a Western Hemisphere trade corporation under section 921 of the Internal Revenue Code of 1954. In a subsequent taxable year, the Internal Revenue Service, under the authority of section 482 of the Code, determined that an allocation of certain items of gross income and deductions between the subsidiary corporation and its parent corporation was necessary in order to clearly reflect the income of both corporations. The allocation under section 482 of the Code did not itself

disqualify the subsidiary corporation as a Western Hemisphere trade corporation. However, as a result of the allocation, interest payments were made to the subsidiary corporation based upon a refund of income taxes paid by the subsidiary. *Held,* the interest income is includible in the subsidiary corporation's gross income for Federal income tax purposes. However, under the circumstances in this case such amounts will not be taken into account in determining whether the taxpayer qualifies as a Western Hemisphere trade corporation, if it meets the requirements of section 921 of the Code in all other respects. *Held further,* although this interest income is includible in the subsidiary corporation's taxable income for the purpose of computing the tax imposed by section 11 of the Code, or the alternative tax imposed by section 1201 of the Code, such interest income is not includible in the subsidiary corporation's taxable income for the purpose of computing the special deduction allowed by section 922 of the Code.

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26 CFR 1.921–1: Definition of Western Hemisphere trade corporation.

A qualified Western Hemisphere trade corporation is not considered to have had more than incidental economic contact with countries outside the Western Hemisphere where sales of its products to purchasers outside the Western Hemisphere are promoted by a related corporation for a reasonable fee.

Rev. Rul. 69–612

Advice has been requested whether, under the circumstances described below, Corporation *X,* a corporation otherwise qualified as a Western Hemisphere trade corporation, is considered as having had more than incidental economic contact with countries outside the Western Hemisphere, within the meaning of section 1.921–1 of the Income Tax Regulations.

Domestic corporation *X,* a wholly-owned subsidiary of domestic corporation *Y,* carried on its business activities as manufacturer, promoter, and seller of certain related products through branch operations in Canada, South America, and Puerto Rico. The Canadian branch of *X* manufactured and sold a product that certain European subsidiaries of *Y* desired to market in their respective countries. No employees of *X* or its branches, including officers and directors, traveled to countries outside the Western Hemisphere for purposes of promoting sales or any other business activities of *X.* No catalog or similar information listing the various products available by size, quantity, etc., was issued by *X* to European subsidiaries of *Y.* These European corporations contacted *Z,* a second domestic subsidiary of *Y,* regarding the availability of the desired product.

Z was organized for the purpose of rendering various management and technical services to *Y*'s subsidiaries throughout the world in the production and marketing operations of the affiliated group. *Z* maintained its own personnel staff and received a reasonable fee for the services it rendered to affiliates.

Z notified the European corporations of the availability of the desired product from *X.* The European corporations then corresponded directly with the Canadian branch of *X* regarding the desired product and sent the resulting orders directly to *X*'s Canadian plant. *Z* received a reasonable commission from *X* on placement of the order. The product was shipped F.O.B. at the Canadian plant and the European purchasers were billed by *X* for the product. Payment was made to *X* by check and in United States dollars.

Section 921 of the Internal Revenue Code of 1954 provides, in part, that the term Western Hemisphere trade corporation means a domestic corporation *all of whose business is done* in any country or countries in North, Central, or South America, or in the West Indies.

In connection with this statutory provision, section 1.921–1(a)(1) of the regulations states, in part, that merely incidental economic contact with countries outside the Western Hemisphere will not disqualify a corporation as a Western Hemisphere trade corporation.

It is held that, under the foregoing circumstances, *X* is not considered to have had more than incidental economic contact with countries outside the Western Hemisphere, within the meaning of section 1.921–1 of the regulations.

Subpart D—Possessions of the United States

Section 931.—Income From Sources Within Possessions of the United States

26 CFR 1.931–1: Citizens of the United States and domestic corporations deriving income from sources within a certain possession of the United States.

Application of percentage requirements of section 931(a) of the Code with respect to a citizen whose assignments are rotated between Wake Island and the United States.

Rev. Rul. 69–481

Advice has been requested whether an individual is entitled to the benefits of section 931(a) of the Internal Revenue Code of 1954, for the taxable year ended December 31, 1966, under the circumstances described below.

The taxpayer, a citizen of the United States, was employed by a United States corporation. His assignments were rotated between Wake Island and the United States.

Taxpayer's place of employment and the type, amount, and source of his income for the taxable years ended December 31, 1964, 1965, and 1966 were as follows:

Place of employment, period and type of income	Source and amount		Total all sources
	Wake Island	United States	
1964			
United States:			
Jan. 1–Jan. 31 (Commissions)	0	$600	$600
Wake Island:			
Feb. 1–Dec. 31 (Wages)	$9,000	0	9,000
1965			
United States:			
Jan. 1–Apr. 10 (Commissions)	0	1,400	1,400
Wake Island:			
Apr. 11–Dec. 31 (Wages)	8,000	800	8,800
1966			
United States:			
Jan. 1–July 20 (Commissions and rent)	0	4,900	4,900
Wake Island:			
July 21–Dec. 31 (Wages)	6,000	2,000	8,000
Total	23,000	9,700	32,700

The United States source income shown for the periods Apr. 11–Dec. 31, 1965, and July 21–Dec. 31, 1966, were wages that had been earned in the United States but were received while the taxpayer was in Wake Island. The wages earned in Wake Island were received in Wake Island.

Section 931(a) of the Code provides the general rule that in the case of a citizen of the United States, gross income means only gross income from sources within the United States if 80 percent or more of the gross income of such citizen (computed without the benefit of that section) *for the 3-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable)* was derived from sources within a possession of the United States; and if in the case of such citizen, 50 percent or more of his gross income (computed without the benefit of that section) *for such period or such part thereof* was derived from the active conduct of a trade or business within a possession, either on his own account or as an employee or agent of another.

For the purpose of determining the applicable period under section 931(a) of the Code in the case of an individual who is employed in a United States possession and in the United States intermittently during the 3-year period immediately preceding the close of the taxable year, the expressions "such part of such period immediately preceding the close of such taxable year as may be applicable" and "such period or such part thereof" mean the portion of the 3-year period immediately preceding the close of the taxable year in which the individual was employed in a possession of the United States, and not the full 3-year period.

The individual must base his computation for the determination as to whether his income meets the percentage requirements of section 931(a) of the Code upon his total income from all sources for those intervals constituting the applicable period. See *Julian Larcombe Schley* v. *Commissioner*, 42 B.T.A. 434 (1940), acquiescence, C.B. 1940–2, 6, involving the same issue under section 251(a) of the Revenue Act of 1936, the predecessor of section 931 of the 1954 Code.

In the instant case, the taxpayer's applicable period for purposes of section 931(a) of the Code consists of those intervals during 1964, 1965, and 1966 in which he was employed in Wake Island. During such intervals gross income which he derived from that source amounted to $23,000.00 for personal services rendered within such possession. Gross income from all sources during such intervals amounted to $25,800 ($9,000+$8,800+$8,000).

Since more than 80 percent of taxpayer's gross income from all sources for those intervals during the calendar years 1964, 1965, and 1966 in which he was employed in Wake Island was derived from sources within a possession of the United States, and since more than 50 percent of such gross income was derived from the active conduct of a trade or business within such possession as an employee, it is held that his gross income derived from Wake Island sources during the calendar year 1966 is excludable from his gross income under section 931(a) of the Code. However, in accordance with section 931(b) of the Code, all amounts received by a taxpayer within the United States, whether derived from sources within or without the United States, are included in his gross income.

Section 934.—Limitation on Reduction in Income Tax Liability Incurred to the Virgin Islands

26 CFR 1.934–1: Limitation on reduction in income tax liability incurred to the Virgin Islands.

Treatment, for purposes of section 902 of the Code, of a subsidy which reduces, or is remitted against, the income tax liability incurred to the Virgin Islands. See Rev. Rul. 69–433, page 153.

Subpart F—Controlled Foreign Corporations

Section 955.—Withdrawal of Previously Excluded Subpart F Income from Qualified Investment

26 CFR 1.955–5: Definition of less developed country corporation.

Where a foreign corporation organized in a less developed country sells its land therein and, under local law and contract terms,

retains title until full payment, such contracts will be treated as "interests in real estate" under section 1.955–5(a)(2)(ii) of the regulations.

Rev. Rul. 69–485

A foreign corporation organized under the laws of a country designated as a "less developed country" pursuant to the provisions of section 955(c)(3) of the Internal Revenue Code of 1954 and Executive Order 11071, C.B. 1963–1, 137, subdivided and sold land that it had owned in the less developed country. These contracts generally required a small downpayment and the balance in equal monthly installments. Under the local law and according to the terms of the contracts, title to the land is legally retained by the seller until it is actually conveyed to the purchaser upon payment of the contract price in full. The purchaser only has an equitable right for specific performance with respect to obtaining title when he pays his contract in full.

Held, the contracts held by the foreign corporation in the instant case evidence "interests in real estate" within the meaning of section 1.955–5(a)(2)(ii) of the Income Tax Regulations. Therefore, these contracts are considered as property used in a trade or business and located in a less developed country for the purpose of determining whether the foreign corporation is a less developed country corporation under section 955(c)(1)(B)(i) of the Code.

Subpart G. Export Trade Corporations

Section 970.—Reduction of Subpart F Income of Export Trade Corporations

26 CFR 1.970–1: Export trade corporations.

Whether in computing "export trade assets" under section 971(c) of the Code a taxpayer must take into account in determining working capital reasonably necessary for the production of export trade income, the excess of the current liabilities over current assets. See Rev. Rul. 65–549, this page.

Section 971.—Definitions

26 CFR 1.971–1: Definition with respect to export trade corporations.
(Also Section 970; 1.970–1.)

A controlled foreign corporation will not take into account an excess of current liabilities over current assets in determining working capital reasonably necessary for the production of export trade income, for purposes of computing export trade assets.

Rev. Rul. 69–549

Advice has been requested whether the taxpayer, a controlled foreign corporation that qualifies as an export trade corporation, must take into account in computing "export trade assets" as defined in section 971(c) of the Internal Revenue Code of 1954, the excess of the current liabilities over current assets (negative working capital).

Section 970(a)(1) of the Code provides that in the case of a controlled foreign corporation which for the taxable year is an export trade corporation, the subpart F income of such corporation for such year shall be reduced by an amount equal to so much of the export trade income as constitutes foreign base company income. The amount of the reduction, however, is subject to various limitations. One of the limitations, provided in section 970(a)(2) of the Code, requires that the reduction shall not exceed an amount which bears the same ratio to the increase in investments in export trade assets (as defined in section 971(c) of the Code) of the corporation for such year as the export trade income which constitutes foreign base company income for such year, bears to the entire export trade income of such corporation for such year.

Export trade assets are defined in section 971(c) of the Code to mean:

(1) Working capital reasonably necessary for the production of export trade income;

(2) Inventory of export property held for use, consumption, or disposition outside the United States;

(3) Facilities located outside the United States for the storage, handling, transportation, packaging, or servicing of export property; and

(4) Evidences of indebtedness executed by persons, other than related persons, in connection with payment for purchases of export property, for use, consumption, or disposition outside the United States, or in connection with the payment of certain services attributable to the earning of export trade income or income attributable to the use of export property.

Section 1.970–1(d)(1)(i) of the Income Tax Regulations provides, in substance, that working capital reasonably necessary for the production of export trade income shall be taken into account at the adjusted basis of current assets, determined as of the date for determining the amount by which export trade income shall reduce subpart F income, less any current liabilities. Section 1.970–1(d)(1)(ii) of the regulations provides, in effect, that other "export trade assets" shall be taken into account at their adjusted bases reduced only by those liabilities which constitute a specific charge against such assets.

Working capital of a controlled foreign corporation is defined in section 1.971–1(c)(2) of the regulations as the excess of its current assets over its current liabilities.

Working capital represents the relatively liquid portion of total enterprise capital that constitutes a margin or buffer for meeting obligations within the ordinary operating cycle of the business. Thus, if the current liabilities exceed the current assets, no such margin or buffer exists, and hence there is no working capital within the meaning of section 971(c)(1) of the Code and section 1.971–1(c)(2) of the regulations.

To hold that an excess of current liabilities over current assets (negative working capital) may be used in computing export trade assets would require a reduction in assets not specifically included in working capital, such as warehouse and transportation

facilities included under section 971 (c) (3) of the Code. This would be contrary to the requirements of section 1.970–1 (d) (1) (ii) of the regulations that a liability will not be taken into account for the purpose of reducing the adjusted basis of export trade assets which are not subject to such liability.

Accordingly, the taxpayer in computing "export trade assets" as defined in section 971 (c) of the Code will not take into account, in determining "working capital" reasonably necessary for the production of export trade income, an excess of current liabilities over current assets.

Subchapter O. Gain or Loss on Disposition of Property

Part I—Determination of Amount of and Recognition of Gain or Loss

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Section 1001.—Determination of Amount of and Recognition of Gain or Loss

26 CFR 1.1001–1: Computation of gain or loss.

Treatment of a non-pro rata distribution of trust property in kind by a trustee who has no authority to make such distribution but did so as a result of a mutual agreement between the two beneficiaries.

Rev. Rul. 69–486

Advice has been requested as to the Federal income tax treatment of a final distribution of property in kind by a trustee to the two beneficiaries of a trust under the circumstances described below.

Under terms of the trust instrument, the trustee is required to distribute currently all trust income to *B* for her life and upon her death distribute one-half of the trust corpus to *C*, an individual, and one-half to *X*, a charitable organization exempt from tax under section 501 (c) (3) of the Internal Revenue Code of 1954.

B died on July 1, 1967. At the time of her death, the trust had ordinary income of $20x$ dollars to be reported in its current calendar year period. Subsequent to *B*'s death the trust received no income up to its termination on August 1, 1967. The distributable net income of the trust for 1967 as defined by section 643 (a) of the Code was $20x$ dollars. The trustee properly distributed currently $20x$ dollars to *B*'s successor in interest.

At the time of *B*'s death, the trust corpus to be distributed to *C* and *X* consisted in part of notes that had been purchased by the trust and that had a total adjusted basis of $300x$ dollars and a total fair market value of an equal amount. The balance of the trust corpus consisted of common stock acquired by purchase with a total adjusted basis of $100x$ dollars and a total fair market value of $300x$ dollars.

The trust instrument as well as local law was silent as to the authority of the trustee to make a non-pro rata distribution of property in kind.

By mutual agreement, the two beneficiaries requested that the trustee distribute all of the notes to *C* and all of the common stock to *X*. The trustee complied with this request on August 1, 1967.

The first issue to be decided is how the non-pro rata distribution by the trustee to *C* and *X* will be treated for Federal income tax purposes.

Since the trustee was not authorized to make a non-pro rata distribution of property in kind but did so as a result of the mutual agreement between *C* and *X*, the non-pro rata distribution by the trustee to *C* and *X* is equivalent to a distribution to *C* and *X* of the notes and common stock pro rata by the trustee, followed by an exchange between *C* and *X* of *C*'s pro rata share of common stock for *X*'s pro rata share of notes.

The second issue to be decided is the basis of the pro rata share of notes and common stock in the hands of *C* and *X*.

Section 661 of the Code as implemented by section 1.661 (a)–2 (f) (3) of the Income Tax Regulations provides, in pertinent part, that the basis of property in the hands of the beneficiary is its fair market value at the time it was paid, credited, or required to be distributed, to the extent such value is included in the gross income of the beneficiary. To the extent that the value of property distributed in kind is not included in the gross income of the beneficiary, its basis in the hands of the beneficiary is governed by the rules in sections 1014 and 1015 of the Code and the regulations thereunder.

Section 661 of the Code provides for a deduction (limited to the distributable net income of the trust) to the trust for distributions properly made and section 662 of the Code provides for the inclusion of a corresponding amount in gross income of a beneficiary.

Inasmuch as the $20x$ dollars of income required to be distributed currently to the estate of *B* is equal to the distributable net income of the trust, no amount is includible in the gross income of *C* and *X* as a result of the pro rata distribution of notes and common stock by the trustee. See section 662 (a) of the Code as implemented by section 1.662 (a)–2 of the regulations.

The basis of the pro rata shares of notes and common stock in the hands of *C* and *X* is the same as the adjusted basis in the hands of the trust. See section 1.1015–2 (b) of the regulations.

Furthermore, *C* in substance exchanged his pro rata share of common stock with *X* for *X*'s pro rata share of notes. The amount of recognized gain to *C* is determined under sections 1001 and 1002 of the Code. Since *X* is a charitable organization exempt from tax under section 501 (c) (3) of the Code, it has no tax consequence as a result of the exchange.

Part II. Basis Rules of General Application

Section 1012.—Basis of Property—Cost

26 CFR 1.1012–1: Basis of property. (Also Section 1236; 1.1236–1.)

Revenue Ruling 67–419 is amplified to be made applicable to transactions to which the "book-entry

Treasury security" rules have been extended by the amendment of section 1.1012–1(c)(7)(ii)(a) of the regulations.

Rev. Rul. 69–416 [1]

Treasury Decision 7015, published in the Federal Register dated June 20, 1969, this page, amends section 1.1012–1(c)(7)(ii)(*a*) of the Income Tax Regulations to expand the types of transactions to which the "book-entry Treasury security" rules contained in the regulations under section 1012 of the Internal Revenue Code of 154 are applicable. These identification rules are used in certain circumstances to determine the basis and holding period of book-entry Treasury securities upon their sale or transfer.

Revenue Ruling 67–419, C.B. 1967–2, 265, specifies the information to be contained in a written instruction to sell or transfer a book-entry Treasury security in order that a "serially-numbered advice of transaction" will satisfy the "written confirmation" requirements of section 1.1012–1(c)(3)(i)(*b*) of the regulations. In addition, Revenue Ruling 67–419 states that for purposes of section 1236 of the Code and the regulations thereunder (relating to the identification of securities held by a dealer for investment), the identification of a particular book-entry Treasury security in the dealer's books of account by reference to the "serially-numbered advice of transaction" furnished by the "Reserve Bank" (as those terms are defined in section 1.1012–1(c)(7) of the regulations) upon the acquisition of such security is a satisfactory method of identification.

Revenue Ruling 67–419 is hereby amplified to be made applicable to transactions to which the book-entry Treasury security rules have been extended by the amendment of section 1.1012–1(c)(7)(ii)(*a*) of the regulations.

[1] Also released as Technical Information Release 1018, dated July 11, 1969.

26 CFR 1.1012–1: Basis of property.

T.D. 7015

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

Identification of book-entry Treasury securities.

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 modify the identification rules for purposes of determining basis and holding period of property in the case of certain Treasury securities, paragraph (c)(7)(ii)(*a*) of § 1.1012–1 of the Income Tax Regulations (26 CFR Part 1) is amended to read as follows:

§ 1.1012–1 Basis of property.

* * * * *

(c) *Sale of stock.* * * *

(7) *Book-entry Treasury securities.* * * *

(ii) * * *

(*a*) The term "book-entry Treasury security" means a transferable Treasury bond, note, certificate of indebtedness, or bill issued under the Second Liberty Bond Act (31 U.S.C. 774(2)), as amended, in the form of an entry made as prescribed in 31 CFR Part 306, Subpart O, on the records of a Reserve Bank which is deposited in an account with a Reserve Bank (*1*) as collateral pledged to a Reserve Bank (in its individual capacity) for advances by it, (*2*) as collateral pledged to the United States under Treasury Department Circular No. 92 or 176, both as revised and amended, (*3*) by a member bank of the Federal Reserve System for its sole account for safekeeping by a Reserve Bank in its individual capacity, (*4*) in lieu of a surety or sureties upon the bond required by section 61 of the Bankruptcy Act, as amended (11 U.S.C. 101), of a banking institution designated by a judge of one of the several courts of bankrupty under such section as a depository for the moneys of a bankrupt's estate, (*5*) pursuant to 6 U.S.C. 15, in lieu of a surety or sureties required in connection with any recognizance, stipulation, bond, guaranty, or undertaking which must be furnished under any law of the United States or regulations made pursuant thereto, (*6*) by a banking institution, pursuant to a state or local law, to secure the deposit in such banking institution of public funds by a state, municipality, or other political subdivision, (*7*) by a state bank or trust company or a national bank, pursuant to a state or local law, to secure the faithful performance of trust or other fiduciary obligations by such state bank or trust company or national bank, or (*8*) to secure funds which are deposited or held in trust by a state bank or trust company or a national bank and are awaiting investment, but which are used by such state bank or trust company or national bank in the conduct of its business;

* * * * *

Because this Treasury decision merely liberalizes the identification rules for purposes of determining basis and holding period in the case of certain securities, it is found that it is unnecessary to issue this Treasury decision with notice and public procedure thereon under 5 U.S.C. 553 (b), or subject to the effective date limitation of 5 U.S.C. 553 (d).

(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).)

RANDOLPH W. THROWER,
Commissioner of Internal Revenue.

Approved June 4, 1969.

EDWIN S. COHEN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on June 19, 1969, 8:48 a.m., and published in the issue of the Federal Register for June 20, 1969, 34 F.R. 9672)

Part III—Common Nontaxable Exchanges

Section 1033.—Involuntary Conversions

26 CFR 1.1033(a)–1: Involuntary conversion; nonrecognition of gain.

The sale of restricted common stock because the owner no longer meets the corporation's requirements for ownership is not an involuntary conversion under section 1033 of the Code; I.T. 2247 superseded.

Rev. Rul. 69–550 [1]

The purpose of this Revenue Ruling is to update and restate under the current statute and regulations the position set forth in I.T. 2247, C.B. IV–2, 19 (1925).

The question presented is whether the sale of stock under the circumstances described below constitutes an involuntary conversion of property within the meaning of section 1033 of the Internal Revenue Code of 1954.

A acquired a minority interest in the common stock of a corporation. The following restriction was printed on the back of each certificate of common stock of the corporation:

"No common stock of this corporation shall be issued or transferred to any person who is not an officer or director of this corporation, except with the consent of the board of directors evidenced by a resolution duly passed at a regular meeting of the board, or at a special meeting called for such purpose, and every member who desires to sell his stock, and every member, who for any reason shall cease to be an officer or director, his personal representatives, legatees or assigns, shall be required, at the time of the taking of the next inventory as hereinafter provided for to offer in writing to the board of directors to sell the number of shares of the capital stock held by him to such person or persons as the board of directors shall designate by a resolution duly passed at and for the same sum per share as is equaled by the quotient obtained by dividing the total net amount of the inventory of all the property and assets, after deducting all liabilities, less the amount of the par value of all of the preferred stock then issued and outstanding, by the number of shares of common stock then outstanding, and such member, his personal representatives, legatees or assigns, shall immediately, upon the payment or tender to him in cash, of such price per share, transfer and assign the shares of stock held by him to such person or persons so designated by the board of directors; * * *.

* * * * *

"All common stock shall be issued subject to the conditions and restrictions contained in this section, which shall be printed on the back of each and every certificate, and attention called thereto on the face thereof, and each and every member shall take and hold his common stock subject to the above conditions and restrictions, and by the acceptance of the certificate therefor shall be held to have agreed to all of the said conditions and restrictions and to have covenanted that he will not violate any of the same."

The by-laws of the corporation provide that all officers, directors, and agents of the corporation shall hold their offices or positions at the pleasure of the board of directors, and that any officer, director, or agent may at any time be removed with or without cause by vote of a majority of the board of directors. In 1968 the board of directors adopted a resolution providing for the removal of *A* from the board of directors. *A* thereupon offered to sell the common stock held by him to the board of directors, in compliance with the restrictions pertaining to the transfer of the stock. The offer was accepted. *A* invested the proceeds of the sale in common stock of another company.

Section 1033(a) of the Code provides special rules for the treatment of gain if property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted into cash and other property similar or related in service or use to the property so converted is purchased.

Section 1.1033(a)–1 of the Income Tax Regulations provides that section 1033 of the Code applies to cases where property is compulsorily or involuntarily converted. It further provides that an "involuntary conversion" may be the result of the destruction of property in whole or in part, the theft of property, the seizure of property, the requisition or condemnation of property, or the threat or imminence of requisition or condemnation of property.

In the present case, the stock was not converted into money as a result of fire, shipwreck, condemnation, or similar causes.

Accordingly, the sale of the stock does not constitute an involuntary conversion of property within the meaning of section 1033 of the Code and the special provisions therein do not apply to the sale of the stock. The gain or loss arising from the sale should be computed in accordance with the provisions of section 1001 of the Code.

I.T. 2247 is hereby superseded since the position stated therein is restated under current law in this Revenue Ruling.

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26 CFR 1.1033(a)–2: Involuntary conversion where disposition of the converted property occurred after December 31, 1950.

The exchange of other like kind property plus cash to replace property involuntarily converted is a purchase of replacement property to the extent of the cash paid for purposes of section 1033 of the Code.

Rev. Rul. 69–639

Advice has been requested whether the transaction described below is considered a purchase of replacement property for purposes of the provisions of section 1033 of the Internal Revenue Code of 1954 dealing with nonrecognition of gain.

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

The taxpayer's farmland was condemned for public use by a governmental body. The taxpayer received 120*x* dollars upon the condemnation realizing a gain of 100*x* dollars which he elected not to recognize under the provisions of section 1033(a) of the Code.

Within the period of time prescribed by section 1033(a) of the Code, the taxpayer acquired other farm property (with a fair market value of 220*x* dollars) in exchange for other property that he owned (which, at the date of exchange, had an adjusted basis in his hands of 50*x* dollars, and a fair market value of 80*x* dollars) plus cash in the amount of 140*x* dollars. No gain was recognized upon the exchange under the provisions of section 1031(a) of the Code which provide that no gain or loss will be recognized from exchanges of property solely in kind.

Section 1033(a) of the Code provides that if property is involuntarily converted as a result of condemnation and the taxpayer purchases similar replacement property, within a prescribed period of time, he may elect to have the gain from the conversion recognized only to the extent that the amount realized upon the conversion exceeds the cost of the replacement property.

For purposes of nonrecognition of gain, section 1033(a)(3)(A)(ii) of the Code provides that the taxpayer should be considered to have purchased property only if, but for the provisions of section 1033(c) of the Code (relating to basis of property acquired to replace involuntarily converted property), the unadjusted basis of such property would be its cost within the meaning of section 1012 of the Code. Under section 1031(d) of the Code, the basis of property acquired in an exchange described in section 1031(a) of the Code is the same as that of the property exchanged with proper adjustments to the date of exchange. Where, as in the instant case, additional consideration is given the basis of the property acquired in the exchange is adjusted (increased), pursuant to section 1016 of the Code, by the amount of such additional consideration. See section 1.1031(d)-1(a) of the Income Tax Regulations.

Accordingly, the replacement property acquired by the taxpayer in the instant case is considered to have been purchased for purposes of section 1033(a) of the Code to the extent of the cash paid for the property. The total basis of the property so acquired is its basis as determined under section 1031(d) of the Code and the regulations thereunder (the adjusted basis of the property exchanged, 50*x* dollars, plus the cash consideration of 140*x* dollars, or 190*x* dollars) decreased by the gain not recognized under section 1033(a) of the Code (100*x* dollars) as required by section 1033(c) of the Code, or 90*x* dollars.

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26 CFR 1.1033(a)-2: Involuntary conversion where disposition of the converted property occurred after December 31, 1950.

A taxpayer who voluntarily reserved property for a school site as a condition to receiving zoning approval for a subdivision may not treat the subsequent sale to school authorities as an involuntary conversion, even though such sale is made under condemnation proceedings.

Rev. Rul. 69–654

Advice has been requested whether, under the circumstances described below, property is involuntarily converted for purposes of the nonrecognition of gain provisions of section 1033 of the Internal Revenue Code of 1954.

The taxpayer, a real estate developer, acquired unimproved land for the purpose of subdividing it into residential lots for the construction and sale of homes. At the time the taxpayer acquired the land he knew that before the planning and zoning authorities would approve development, the school district investigates the property to determine if sites for future schools are needed. If it is determined by the school district that future schools should be provided for, a site will be selected. If the developer decides he does not want to give up the site, he can withdraw his application for zoning approval and not develop the land for the construction and sale of homes.

In the instant case, the school district decided that a school would be needed and selected a site which was set aside and designated on the subdivision map. The taxpayer accepted the decision that the land would be taken, as a condition to developing the remaining property. This property will remain vacant until needed for construction of a school at which time the school district will acquire it from the taxpayer by condemnation proceeding if the parties cannot agree upon the issue of just compensation. Thus, the condemnation proceedings would merely determine the value of the property and not the right of the school district to take the property.

Section 1033(a) of the Code provides for the nonrecognition of gain upon the involuntary conversion of property as a result of condemnation, or a sale under threat or imminence thereof, if the taxpayer so elects and the conditions of section 1033 of the Code are otherwise met.

The term "condemnation," as used in section 1033 of the Code, refers to the process by which private property is taken for public use *without the consent* of the property owner but upon the award and payment of just compensation. See Revenue Ruling 57–314, C.B. 1957–2, 523. A conversion of property is not involuntary within the meaning of section 1033 of the Code where, as in the instant case, the property owner voluntarily consents to the subsequent conversion of part of his property as a condition to receiving zoning approval for the development of his remaining property.

Accordingly, the taxpayer in this case will not be entitled to the benefits of section 1033 of the Code upon the acquisition of his land by the school district for the building of a school.

Section 1034.—Sale or Exchange of Residence

26 CFR 1.1034–1: Sale or exchange of residence.

Gain realized on the sale of a residence must be reported where a taxpayer purchases a new residence but does not actually occupy it as his principal residence within the time prescribed under section 1034 of the Code.

Rev. Rul. 69–434

Advice has been requested regarding the treatment, for Federal income tax purposes, of the gain realized by a taxpayer upon the sale of his personal residence under the circumstances described below.

The taxpayer, an employee, resided in his personal residence in city *R*. He accepted a two-year assignment in city *S*, sold his residence at a gain, and immediately purchased a residence in city *T* (the city in which he planned to spend his retirement years). The taxpayer rented a residence in city *S* during the time he worked there, and his son occupied the residence in city *T* during that time. Upon completion of his two-year assignment, the taxpayer retired and moved into his residence in city *T*.

The question is whether the taxpayer satisfies the requirements of section 1034 of the Internal Revenue Code of 1954 relative to reporting the gain realized on the sale of the residence in city *R*.

Section 1034(a) of the Code provides, in part, that if property used by the taxpayer as his principal residence is sold by him after December 31, 1953, and within a period beginning one year before the date of such sale and ending one year after such date, property is purchased and used by the taxpayer as his principal residence, gain from such sale shall be recognized only to the extent that the taxpayer's adjusted sales price of the old residence exceeds his costs of purchasing the new residence.

Section 1.1034–1(c)(3) of the Income Tax Regulations provides, in part, that whether or not property is used by the taxpayer as his residence, and whether or not property is used by the taxpayer as his principal residence (in the case of a taxpayer using more than one property as a residence), depends upon all the facts and circumstances in each case, including the good faith of the taxpayer.

The Tax Court of the United States in *William C. Stolk* v. *Commissioner,* 40 T.C. 345 (1963), affirmed per curiam 326 F. 2d 760 (1964), in discussing section 1034 of the Code stated as follows:

> The statute requires that the new residence must be used as the taxpayer's principal residence within one year from the date of the sale of the old one. . . . In order to meet the prescribed requirement, the taxpayer must prove that the new property was his *principal* residence. It is not enough to establish that he occupied and used the new property as a residence.

The taxpayer in the instant case purchased the residence in city *T* with the intent of occupying it as his principal residence only following completion of his two-year assignment. Actually, his principal residence during the two-year period in question was in city *S*. The fact that he purchased the residence in city *T* and had a member of his family occupy it does not permit him to designate that residence as his principal residence for purposes of section 1034 of the Code.

Accordingly, the taxpayer in the instant case does not satisfy the requirements of section 1034 of the Code and, therefore, he must report the gain he realized upon the sale of his principal residence in city *R*.

Subchapter P. Capital Gains and Losses

Part II—Treatment of Capital Losses

Section 1211.—Limitation on Capital Losses

26 CFR 1.1211–1: Limitation on capital losses.
(Also Section 61; 1.61–12.)

Gain realized by a corporation on the open-market purchase and retirement of its own bonds is ordinary income and may not be offset against losses sustained on the sale or exchange of capital assets; I.T. 2846 superseded.

Rev. Rul. 69–613 [1]

The purpose of this Revenue Ruling is to update and restate under the current statute and regulations, the position set forth in I. T. 2846, C. B. XIV–1, 112 (1935).

The question presented is whether the gain realized by a corporation on the purchase and retirement of its own bonds constitutes capital gain that may be offset against losses sustained on the sale or exchange of capital assets.

M corporation sustained losses during the taxable year on the sale of capital assets. It also realized a gain of $7x$ dollars as a result of the purchase of its own bonds in the principal amount of $27x$ dollars, on the open market for $20x$ dollars.

Section 1211(a) of the Internal Revenue Code of 1954 provides that losses of a corporation from sales and exchanges of capital assets shall be allowed only to the extent of gains from sales or exchanges.

Section 1232(a) of the Code specifically provides that amounts received by the holder on retirement of bonds shall be considered as amounts received in exchange therefor. The statute does not contain any such provision with respect to the transaction as viewed from the standpoint of the "obligor corporation." There is no "sale or exchange" by the corporation in such a case as required by the statute. See *John H. Watson, Jr.,* v. *Commissioner,* 27 B.T.A. 463 (1932), acquiescence, C.B. XII–1, 13 (1933).

Accordingly, it is held that the gain realized by the corporation from the retirement of its bonds does not constitute gain from a sale or exchange but is treated as ordinary income. Therefore, such gain may not be offset against losses sustained on the sale or exchange of capital assets in determining the amount of the deduction for such losses under section 1211(a) of the Code.

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[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

I.T. 2846 is hereby superseded since the position stated therein is restated under current law in this Revenue Ruling.

Part III—General Rules for Determining Capital Gains and Losses

Section 1221.—Capital Asset Defined

26 CFR 1.1221–1: Meaning of terms.

Whether amount received under an agreement not to compete is ordinary income. See Rev. Rul. 69–643, page 10.

Part IV—Special Rules for Determining Capital Gains and Losses

Section 1235.—Sale or Exchange of Patents

26 CFR 1.1235–1: Sale or exchange of patents.

The mere fact that a patent transfer for contingent amounts does not qualify for long-term capital gains treatment under section 1235 of the Code will not prevent it from qualifying for such treatment under other provisions of the Code.

Rev. Rul. 69–482

Advice has been requested whether a holder of a patent who makes a transfer of the patent to a related party for contingent amounts is precluded from obtaining long-term capital gains treatment of the proceeds of such a transfer under provisions of the internal revenue laws other than section 1235 of the Internal Revenue Code of 1954 by reason of the provisions of section 1235(d) of the Code.

In the instant case, the taxpayer (a "holder" as that term is defined by section 1235(b) of the Code) transferred, in a bona fide business transaction, all substantial rights in a patent to a corporation in which he owned one-third of the outstanding stock. The corporation is making payments for the patent in the form set forth in section 1235 of the Code. In the hands of the taxpayer, the patent was a capital asset as defined in section 1221 of the Code and had been held for a period in excess of six months.

Section 1235(a) of the Code provides, in pertinent part, that a transfer (other than by gift, inheritance, or devise) of property consisting of all substantial rights to a patent, or an undivided interest therein, by a holder is considered the sale or exchange of a capital asset held for more than six months, regardless of when and how the payments are made.

Section 1235(d) of the Code provides, in pertinent part, that section 1235(a) shall not apply to any transfer, directly or indirectly, between related persons as described in section 267(b) of the Code, except that in applying section 267 (b) and (c) for purposes of section 1235(d) the phrase "25 percent or more" shall be substituted for the phrase "more than 50 percent" in section 267(b), and section 267(c) shall be treated as providing that the family of an individual shall include only his spouse, ancestors, and lineal descendants.

Based on the facts, it is clear that the transaction in the instant case does not meet the requirements of section 1235 of the Code and is not eligible for long-term capital gains treatment thereunder because the transfer was to a corporation that is a related person within the meaning of section 1235(d) of the Code.

In the case of *Myron C. Poole, et ux.* v. *Commissioner,* 46 T.C. 392 (1966), acquiescence, C.B. 1966–2, 6 (the acquiescence concerns a deduction for royalty payments made by the corporation), the Tax Court of the United States held, in part, that if the payments for the transfer of a patent are contingent upon productivity, use, or disposition, or if they are payable periodically over a period generally coterminous with the transferee's use of the patent, section 1235 of the Code is the only provision under which the holder can qualify for capital gains treatment. Thus, it was held that since the taxpayer did not qualify for section 1235 treatment, the payments he received were taxable to him as ordinary income. The Tax Court rejected the contention of the taxpayer that if section 1235 of the Code was not applicable, he was nevertheless entitled under other provisions of the law to capital gains treatment for the royalties received.

Section 1.1235–1(b) of the Income Tax Regulations provides that if a transfer is not one described in section 1.1235–1(a) of the regulations, then "section 1235 shall be disregarded in determining whether or not such transfer is the sale or exchange of a capital asset. For example, a transfer by a person other than a holder or *a transfer by a holder to a related person* is not governed by section 1235. The tax consequences of such transfers shall be determined under other provisions of the internal revenue laws." (Emphasis added.)

This interpretation is consistent with Senate Report No. 1622 (1954) 438, 441, which, pertaining to the adoption of section 1235 of the Code, states, in part:

> * * * In enacting this section, for the specific purposes set forth in this report, your committee has no intention of affecting the operation of existing law in those areas without its scope. For example, the tax consequences of the sale of patents in years to which this section is inapplicable, or by individuals who fail to qualify as 'holders,' or by corporations, is to be governed by the provisions of existing law as if this section had not been enacted. * * *

Consistent with this statement and with section 1.1235–1(b) of the regulations, it is the position of the Service that where holders make transfers of patents that do not meet the requirements for capital gains treatment under section 1235 of the Code, the tax consequences of such transfers will be determined under other sections of the Code.

Thus, in Revenue Ruling 58–353, C.B. 1958–2, 408, it was stated, among other things, that in cases not coming within the purview of section 1235 of the Code where interests resembling royalties are retained by the transferor along with other rights, the transac-

tion may fail to have sufficient characteristics of a sale to qualify for capital gains treatment. The implication of this statement is that the transaction may, on the other hand, qualify for such treatment, depending on the facts.

See also Revenue Ruling 59–210, C.B. 1959–1, 217, which provides that if there is a transfer of all substantial rights in a patent by a holder to a corporation in which the transferor owns 80 percent or more of the stock, the transfer does not fall within section 1235 of the Code but is a sale of property described in section 1239 of the Code, and the proceeds are taxable as ordinary income.

Further, in the case of *Max A. Burde* v. *Commissioner,* 43 T.C. 252 (1964), affirmed 352 F. 2d 995 (1965), certiorari denied, 383 U.S. 966 (1966), the Tax Court of the United States, after determining that the petitioner could not rely upon the provisions of section 1235 of the Code for capital gains treatment of royalty payments, considered the application of other sections of the Code to such payments and denied capital gains treatment. The court stated that it was true that if the transfer of a patent or an invention qualifies under section 1235 of the Code, long-term capital gains treatment will be obtained, even though the transferor does not possess the requisite six-month holding period. However, since the court had already decided that the transfer did not qualify under section 1235 of the Code, it determined that the transfer of property rights in the invention would be governed by other provisions of the law and that in order to qualify for long-term capital gains treatment on the royalty payments, the taxpayers must have held the property rights in the invention for more than six months prior to their sale. The court then concluded that, since the property rights in the invention had not been held for more than six months, long-term capital gains treatment was not available.

Therefore, the mere fact that a patent transfer by a holder for contingent amounts does not qualify for long-term capital gains treatment under section 1235 of the Code, will not prevent it from qualifying for such treatment under other provisions of the Code if it would qualify for such treatment in the absence of section 1235. Compare Rev. Rul. 58–353. To the extent that the rationale of the court in the *Poole* case may be construed as contrary to the conclusion in this Revenue Ruling it will not be followed.

Accordingly, the taxpayer in the instant case is entitled to treat the transfer of all substantial rights in the patent as the sale or exchange of a capital asset and the gain therefrom is reportable as long-term capital gain.

Section 1236.—Dealers in Securities

26 CFR 1.1236–1: Dealers in securities.

Identification of a book-entry Treasury security. See Rev. Rul. 69–416, page 159.

Section 1245.—Gain From Dispositions of Certain Depreciable Property

26 CFR 1.1245–1: General rule for treatment of gain from dispositions of certain depreciable property.

The conversion to personal use of an automobile that has been used solely for business is not a "disposition" for purposes of section 1245 of the Code.

Rev. Rul. 69–487

An individual taxpayer operating a business as a sole proprietorship converted to personal use an automobile that had been used solely for business purposes. At that time, the fair market value of the automobile was substantially higher than its adjusted basis.

Held, for the purposes of section 1245 of the Internal Revenue Code of 1954, the conversion to personal use is not a "disposition" of the automobile. Accordingly, there is no gain to be recognized by the taxpayer upon the conversion to personal use. However, the provisions of section 1245 of the Code would apply to any disposition of the automobile by the taxpayer at a later date.

Subchapter S. Election of Certain Small Business Corporations as to Taxable Status

Section 1372.—Election by Small Business Corporation

26 CFR 1.1372–4: Termination of election. (Also Section 368; 1.368–1.)

The election and the taxable year of a small business corporation are not terminated where, in a statutory merger, it acquires the assets of another corporation that is not an electing small business corporation.

Rev. Rul. 69–566

An electing small business corporation, as defined in section 1371(b) of the Internal Revenue Code of 1954, acquired the assets of another corporation, not an electing small business corporation, in a statutory merger within the meaning of section 368(a)(1)(A) of the Code. The electing small business corporation was the surviving corporation, and the stock of the other corporation was cancelled.

Held, the statutory merger in and of itself, did not terminate the corporation's election as an electing small business corporation. *Held further,* the merger did not terminate the electing small business corporation's taxable year.

Section 1374.—Corporation Net Operating Loss Allowed to Shareholders

26 CFR 1.1374–2: Application with other provisions.

Application of section 270 of the Code to a shareholder of an electing small business corporation. See Rev. Rul. 69–584, page 42.

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.

Whether allocation and payment by cooperative qualifies as a patronage dividend. See Rev. Rul. 69–576, this page.

Section 1382.—Taxable Income of Cooperatives

26 CFR 1.1382–2: Taxable income of cooperatives; treatment of patronage dividends.

Whether allocation and payment by cooperative qualifies as a patronage dividend. See Rev. Rul. 69–576, this page.

26 CFR 1.1382–2: Taxable income of cooperatives; treatment of patronage dividends.

Distributions to patrons after dividends paid on stock. See Rev. Rul. 69–621, page 167.

Part III—Definitions; Special Rules

Section 1388.—Definitions; Special Rules

26 CFR 1.1388–1: Definitions and special rules.

A wholesale grocery cooperative is entitled to a deduction for patronage dividends paid its independently operated wholly-owned subsidiary where it deals with the subsidiary on a cooperative basis in the same manner as with its other retail grocer members.

Rev. Rul. 69–389

Advice has been requested whether a corporation wholly-owned by a cooperative corporation as defined in section 1381 of the Internal Revenue Code of 1954, can be considered a bona fide patron of the cooperative for purposes of allowing the cooperative a deduction for patronage dividends under section 1382 of the Code.

X corporation operates as a cooperative in the wholesale grocery field. All of its stock is owned by 2,000 retail grocer members. Among these members is a wholly-owned subsidiary of *X*. The members are required to purchase shares of stock of *X* at par to the extent of three times their average weekly withdrawals of merchandise from *X*. The stock is assigned to *X* to secure the payment for withdrawals of merchandise by its members. When a member terminates his association with *X* he surrenders his stock and is repaid the purchase price of the stock less any debts due *X*. When a member joins *X*, a written contract is executed by the member and *X* which provides that the member shall be entitled to withdraw merchandise from *X* at estimated cost, and the *X* will refund to the member sums received from the member in excess of actual cost. The members withdraw merchandise from *X* at prices that are in excess of cost and at the end of *X*'s taxable year, *X* refunds to its members the entire amount that it has collected from them for withdrawals of merchandise less its cost of operation. This refund is paid to each member on the basis of the member's volume of withdrawals of merchandise during the taxable year.

The wholly-owned subsidiary of *X* has at all times been dealt with by *X* in exactly the same manner as all the other members. The subsidiary withdraws merchandise from *X* in the same manner, at the same prices, and under the same terms as all other members of *X*. At the end of each taxable year the subsidiary is paid a refund on the same basis as all the other members. The subsidiary operates independently of *X* and has its own management and employees.

Section 1382(b) of the Code provides, in relevant 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 the taxable year.

Section 1388(a) of the Code provides that the term "patronage dividend" means an amount paid to a patron by a cooperative organization (1) on the basis of quantity or value of business done with or for the patron (2) under an obligation of such organization to pay such amount, which obligation existed before the organization received the amount so paid, and (3) which is determined by reference to the net earnings of the organization from business done with or for its patrons.

Section 1.1388–1(e) of the Income Tax Regulations provides that the term "patron" includes any person with whom or for whom the cooperative association does business on a cooperative basis, whether a member or a nonmember of the cooperative association, and whether an individual, a trust, estate, partnership, company, corporation, or cooperative association.

In the instant case, it is clear that *X* is dealing with its subsidiary on a cooperative basis the same as with the other members. Furthermore, the refunds made by *X* to the members are made under a pre-existing obligation and are based on its net earnings from business done with its members.

Accordingly, it is concluded that the wholly-owned subsidiary of *X* is a bona fide patron of *X*. It is further concluded that the refunds made by *X* to its members, including *X*'s wholly owned subsidiary constitute patronage dividends within the meaning of section 1388 of the Code for which *X* is entitled to a deduction under section 1382 of the Code.

26 CFR 1.1388–1: Definitions and special rules.
(Also Sections 1381, 1382; 1.1381–1, 1.1382–2.)

Amounts received on a patronage basis by a nonexempt farmers' cooperative and allocated and paid to its patrons qualify as patronage dividends.

Rev. Rul. 69–576

Advice has been requested whether an amount allocated and paid by a nonexempt farmers' cooperative to its patrons (farmers) under the following

circumstances qualifies as a patronage dividend.

A nonexempt farmers' cooperative borrowed money from a bank for cooperatives, itself a cooperative within the meaning of section 1381(a)(2) of the Internal Revenue Code of 1954. The money was borrowed to finance the acquisition of agricultural supplies for resale to its members. The loan was obtained on March 1, 1966, with both the principal and interest payable in full within the taxable year.

After the close of its 1966 taxable year, the bank for cooperatives determined its net earnings which it then allocated to its patrons, including the nonexempt farmers' cooperative, on a patronage basis. The patronage allocations were based on the proportion of the total interest paid to it by each cooperative patron during the 1966 taxable year. The nonexempt farmers' cooperative in the instant case included the patronage allocations received by it from the bank for cooperatives in its gross income for the taxable year received (1967) under section 1385 of the Code. Under a preexisting obligation the nonexempt farmers' cooperative then allocated and paid the same amount it received from the bank for cooperatives to its own patrons (farmers). The issue is whether this latter allocation and payment qualifies as a patronage dividend.

Section 1388(a) of the Code and the regulations thereunder define a "patronage dividend" to mean an amount paid by a cooperative organization to a patron (1) on the basis of quantity or value of business done with or for such patron, (2) under a valid enforceable written obligation of such organization to the patron to pay such amount, which obligation existed before the cooperative organization received the amount so paid, and (3) which is determined by reference to the net earnings of the cooperative organization from business done with or for its patrons. The term "patronage dividend" does not include an amount paid to a patron by a cooperative organization to the extent that such amount is paid out of earnings not derived from business done with or for patrons.

Section 1.1382–3(c)(2) of the Income Tax Regulations defines the term "income derived from sources other than patronage" to mean incidental income derived from sources not directly related to the marketing, purchasing, or service activities of the cooperative association. For example, income derived from the lease of premises, from investment in securities, or from the sale or exchange of capital assets, constitutes income derived from sources other than patronage.

The classification of an item of income as from either patronage or nonpatronage sources is dependent on the relationship of the activity generating the income to the marketing, purchasing, or service activities of the cooperative. If the income is produced by a transaction which actually facilitates the accomplishment of the cooperative's marketing, purchasing, or service activities, the income is from patronage sources. However, if the transaction producing the income does not actually facilitate the accomplishment of these activities but merely enhances the overall profitability of the cooperative, being merely incidental to the association's cooperative operation, the income is from nonpatronage sources.

Accordingly, inasmuch as the income received by the nonexempt cooperative from the bank for cooperatives resulted from a transaction that financed the acquisition of agricultural supplies which were sold to its members, thereby directly facilitating the accomplishment of the cooperative's purchasing activities, it is held that the allocation and payment of this same amount by the nonexempt farmers' cooperative to its own patrons (farmers) qualifies as a patronage dividend. If the allocation and payment to its own patrons (farmers) is made not later than 8½ months after the close of its taxable year, as prescribed in section 1382(b) of the Code, the nonexempt farmers' cooperative is allowed a deduction for the allocation and payment on its Federal income tax return for 1967.

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26 CFR 1.1388–1: Definitions and special rules.
(Also Section 1382; 1.1382–2.)

The amount of a cooperative's net profits distributed to its patrons on a patronage basis in excess of dividends paid on its stock during the taxable year qualifies as a patronage dividend.

Rev. Rul. 69–621

A cooperative organization within the meaning of section 1381(a) of the Internal Revenue Code of 1954 had total net profits for the taxable year from business done with or for its patrons of 100*x* dollars. Its by-laws permit it to pay dividends up to eight percent of the amount paid for its stock. Eight percent of the amount paid for its stock is 40*x* dollars. Its by-laws provide further that any net profits remaining after the payment of dividends on stock shall be distributed on a patronage basis to all of its patrons. The cooperative organization actually paid dividends on its stock during the taxable year at the rate of two percent (10*x* dollars) and paid the remainder of its net profits (90*x* dollars) on a patronage basis to all of its patrons.

Held, the entire amount in excess of the 10*x* dollars (90*x* dollars), qualifies as a patronage dividend within the meaning of section 1388(a) of the Code. Such amount (90*x* dollars) is deductible under section 1382 of the Code if it otherwise meets the requirements of that section with respect to form and timing.

Chapter 2—Tax on Self-Employment Income

Section 1402.—Definitions

26 CFR 1.1402(b)–1: Self-employment income.
(Also Section 441; 1.441–1.)

The maximum tax imposed on self-employment income is appli-

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cable to each of two consecutive short periods resulting from changes in accounting periods, even though the two periods make up only one calendar year.

Rev. Rul. 69–410

Advice has been requested whether, under the circumstances described below, the maximum tax imposed on self-employment income under section 1401 of the Self-Employment Contributions Act (chapter 2, substitle A, Internal Revenue Code of 1954) applies with respect to each of two consecutive short periods resulting from changes in accounting periods, if the two periods make up only one calendar year.

For good business reasons, *A*, a self-employed individual, applied for and received approval to change his accounting period from the calendar year to a fiscal year ending May 31, 1968. As a result of the change, *A* filed a Federal income tax return for the short period beginning January 1, 1968, and ending May 31, 1968, showing no wages paid to him and reporting self-employment income of $7,800 (the maximum amount provided in section 1402(b) of the Act). On the basis of Revenue Ruling 94, C.B. 1953–1, 84, *A* reported and paid the maximum self-employment tax with his tax return for the period ending May 31, 1968. Revenue Ruling 94 holds, in part, that the self-employment tax should be computed on the actual self-employment income for a short period and should not be prorated for a fractional part of a 12-month period.

A found the fiscal year unsatisfactory in his business and he immediately requested and received approval to change back to the calendar year. He filed a Federal income tax return for the short period beginning June 1, 1968, and ending December 31, 1968, showing no wages and reporting his self-employment income of $7,800 for that period, and reporting the maximum self-employment tax.

Section 1401(a) of the Self-Employment Contributions Act imposes a tax, at a prescribed rate, for each "taxable year" on the self-employment income of every individual. Section 1402(b) of the Act provides that self-employment income means the net earnings from self-employment derived by an individual during any "taxable year" subject to a prescribed maximum limitation and reduced by the amount of the wages paid to the individual during the "taxable year."

Under section 441(b) of the Code, the term "taxable year" includes the period for which the return is made, if a return is made for a period of less than 12 months.

It is held that *A* is liable for the self-employment tax on his self-employment income of $7,800 in each of his two short periods in 1968.

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26 CFR 1.1402(c)–1: Trade or business.

Status of physicians performing services for a railway company. See Rev. Rul. 69–390, page 190.

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, foreign partnerships, and foreign corporations.

Federal income tax and interest equalization tax consequences of an "overseas financing" arrangement. See Rev. Rul. 69–377, page 231.

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26 CFR 1.1441–4: Exemptions from withholding.
(Also Section 871; 1.871–1.)

A domestic corporation is not relieved from the requirement of withholding income tax from royalties paid to a nonresident alien even though he has appointed a domestic banker to act as his agent in paying his taxes in the U.S.; O.D. 1087 superseded.

Rev. Rul. 69–655 [1]

A, a nonresident alien who receives royalties from domestic corporation *M*, executed a power of attorney authorizing a domestic bank to act as his agent in all Federal income tax matters. The royalty payments made to *A* do not result from *A*'s active conduct of a trade or business within the United States.

Held, M is not relieved from the requirement, under section 1441 of the Internal Revenue Code of 1954, to withhold a tax at the rate of 30 percent from royalties paid to *A* by reason of the fact that *A* has appointed a domestic bank to act as his agent for the purpose of paying his taxes in the United States.

O.D. 1087, C.B. 5, 193 (1921), is hereby superseded, since the position stated therein is set forth under the current statute and regulations in this Revenue Ruling.

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

Section 1442.—Withholding of Tax on Foreign Corporations

26 CFR 1.1442–1: Withholding of tax on foreign corporations.

Federal income tax and interest equilization tax consequences of an "overseas financing" arrangement. See Rev. Rul. 69–377, page 231.

Chapter 5—Tax on Transfers To Avoid Income Tax

Section 1491.—Imposition of Tax

26 CFR 1.1491–1: Imposition of tax.

The transfer by a United States citizen of appreciated stock, in trust, to a bank in Bermuda is a transfer to a foreign trust subject to the provisions of section 1491 of the Code, even though the grantor is the owner and the trust income must be reported by him.

Rev. Rul. 69–450

Subsequent to January 1, 1967, a citizen of the United States transferred appreciated stock of a corporation, in trust, to a bank incorporated and having its principal place of business in Bermuda. The trust is a foreign trust within the meaning of section 7701(a)(31) of the Internal Revenue Code c

1954. The United States citizen is treated as the owner of the entire trust (corpus as well as income) under the provisions of Subpart E, Part 1, Subchapter J, Chapter 1 of the Code. Therefore, he must take into account in computing his income tax liability all items of income, deduction and credit (including capital gains and losses) to which he would have been entitled had the trust not been in existence during the period he is treated as owner. Section 1.671–3(a)(1) of the Income Tax Regulations.

Held, the transfer of the appreciated stock is a transfer to a foreign trust and is subject to the provisions of section 1491 of the Code (unless section 1492 of the Code applies) even though the grantor is the owner of the entire trust the income of which must be taken into account by him.

Chapter 6—Consolidated Returns

Subchapter A. Returns and Payment of Tax

Section 1501.—Privilege to File Consolidated Returns

26 CFR 1.1501–1: Privilege to file consolidated returns.
(Also Section 243; 1.243–1.)

The election by a common parent to exclude 100 percent of the qualifying dividends received from members of an affiliated group which includes a life insurance company will not preclude the filing of a consolidated return by the nonlife insurance companies of the group.

Rev. Rul. 69–469

P, a domestic corporation, has three wholly-owned domestic subsidiaries: *L,* a life insurance company subject to taxation under section 802 of the Internal Revenue Code of 1954; *C,* a casualty insurance company subject to taxation under section 831 of the Code; and *X,* a noninsurance corporation. *P* and its subsidiaries are members of an affiliated group as defined in section 243(b)(5) of the Code. During 1968 *L, C,* and *X* paid dividends to *P. P,* as common parent and with the consent of *L, C,* and *X,* elected the 100 percent dividends received deduction under section 243(b)(2) of the Code. The election was properly filed in accordance with the statute and the regulations thereunder.

Held, the election of the 100 percent dividends received deduction provided for in section 243(a)(3) of the Code in the case of qualifying dividends does not preclude *P* and its non-life insurance companies, *C* and *X,* from filing a consolidated return under the provisions of section 1501 of the Code, provided all of the requirements for the filing of a consolidated return are met. Further, *P* may deduct on the consolidated return 100 percent of the qualifying dividends received by it in 1968 from *L,* even though under the provisions of section 1504(b)(2) of the Code *L* is not an "includible corporation" for purpose of filing a consolidated return.

Section 1502.—Regulations

26 CFR 1.1502–4: Consolidated foreign tax credit.

Change of overall limitation on foreign tax credit to per-country limitation. See Rev. Rul. 69–518, page 154.

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26 CFR 1.1502–5: Estimated tax.

Members of an affiliated group may file either separate or consolidated declarations of estimated tax for the first two consecutive consolidated return years; thereafter, a consolidated declaration must be filed.

Rev. Rul. 69–622

Advice has been requested whether, under the circumstances described below, members of an affiliated group, as defined in section 1504(a) of the Internal Revenue Code of 1954, may file either separate or consolidated declarations of estimated tax for the first and second consolidated return years.

M and *O,* domestic corporations, are the sole members of an affiliated group. *M* as parent elected, with the consent of *O,* to file a consolidated return for the current taxable year, which is their first consolidated return year.

Section 1.1502–5(a)(1) of the Income Tax Regulations provides, in part, that if a group files a consolidated return for two consecutive taxable years, it shall file its declaration of estimated tax on a consolidated basis for each subsequent taxable year.

Section 1.1502–5(a)(2) of the regulations provides, in part, that if a group is not required to file a consolidated declaration of estimated tax for a taxable year, then each member shall be treated as a separate corporation for such taxable year for the purpose of filing a declaration of estimated tax.

In the instant case *M* and *O* had not filed a consolidated return for two consecutive years. Therefore, they were not required to file a consolidated declaration of estimated tax. However, it is not mandatory that a group file separate declarations in the first two years. See Example 1 under section 1.1502–5(c) of the regulations.

Accordingly, in the instant case, *M* and *O* may file either separate or consolidated declarations of estimated tax for the first and second consecutive consolidated return years. Thereafter section 1.1502–5(a)(1) of the regulations requires *M* and *O* to file a consolidated declaration of estimated tax.

Under sections 103 and 104 of the Revenue and Expenditure Control Act of 1968, Public Law 90–364, C.B. 1968–2, 715, corporations are not required to file declarations of estimated tax for taxable years ending on or after June 30, 1968. However, they are required to make payments of estimated tax by deposit. Thus, in applying the provisions of this Revenue Ruling to taxable years ending on or after June 30, 1968, the term "declaration of estimated tax" should be read as referring to "payments of estimated tax," since the principle established therein is equally applicable under the law as amended.

26 CFR 1.1502–17: Methods of accounting. (Also Section 612; 1.612–4.)

Treatment of intangible development costs incurred by members of an affiliated group that files consolidated returns where only certain members have elected to deduct such expenses currently, and there are intergroup transfers of operating properties and new acquisitions; I.T. 3763 superseded.

Rev. Rul. 69–590 [1]

The purpose of this Revenue Ruling is to update and restate under current statute and regulations, the positions set forth in I.T. 3763, C.B. 1945, 113 (1945).

The questions presented are: (1) whether a common parent, of an affiliated group within the meaning of section 1504(a) of the Internal Revenue Code of 1954, that elected in a prior taxable year to capitalize intangible development costs under section 1.612–4 of the Income Tax Regulations and a subsidiary corporation that elected in such prior year to charge such costs to expenses may, in filing a consolidated return, follow the method that each had elected in the prior taxable year, (2) whether, in the case of an affiliated group filing a consolidated return, a member of the group acquiring from the common parent, or the common parent acquiring from a member of the group, operating properties with respect to which an election under section 1.612–4 of the regulations has been made, is bound, by an election previously made by the acquiring member relative to intangible development costs, and (3) whether a member which has not previously made an election because it had no operating properties is entitled to exercise the option provided, by section 1.612–4 of the regulations upon the acquisition of such properties.

Section 1.612–4 of the regulations provides, in pertinent part, that intangible drilling and development costs incurred by an operator in the development of oil and gas properties may at his option be chargeable to capital account or to expense.

Accordingly, it is held that where the common parent elected in a prior taxable year to capitalize intangible drilling and development cost under section 1.612–4 of the regulations and a member of the group elected in a prior taxable year to charge such costs to expense, the corporations are required, in filing a consolidated return for the current taxable year, to follow the method that each elected in the prior taxable years.

It is also held that where operating properties with respect to which an election under section 1.612–4 of the regulations has been made are acquired from the common parent by a member of the group, or acquired from a member of the group by the common parent, and such corporations file a consolidated return, the acquiring member of the group is bound by its prior election relative to the intangible drilling or development costs to be incurred by it. It is further held that where operating properties are acquired by a member of an affiliated group filing a consolidated return and such member has not previously made an election because it had not previously incurred any intangible drilling and development costs, the member is entitled to exercise the option provided by section 1.612–4 of the regulations, regardless of whether the properties were acquired from a member of the affiliated group.

The foregoing conclusions are applicable for taxable years beginning before January 1, 1966, governed by sections 1.1502–1A through 1.1502–51A of the regulations and for taxable years beginning after December 31, 1966, governed by sections 1.1502–1 through 1.1502–80 of the regulations.

I.T. 3763 is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

26 CFR 1.1502–75: Filing of consolidated returns.

T. D. 7016 [1]

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

Consolidated return regulations

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:

Section 1.1502–75 of the Income Tax Regulations (26 CFR Part 1) under subchapter A of chapter 6 of the Internal Revenue Code of 1954 is amended by adding the following new subdivision (iii) at the end of paragraph (d)(3):

§ 1.1502–75 Filing of consolidated returns.

* * * * *

(d) *When group remains in existence.* * * *

(3) *Reverse acquisitions.* * * *

(iii) The provisions of subdivision (ii) of this subparagraph shall not apply to any acquisition occurring in a taxable year ending after October 7, 1969, unless the first corporation elects to have such subdivision apply. The election shall be made by means of a statement, signed by any officer who is duly authorized to act on behalf of the first corporation, stating that the corporation elects to have the provisions of § 1.1502–75(d)(3)(ii) apply and identifying the acquisition to which such provisions will apply. The statement shall be filed, on or before the due date (including extensions of time) of the return for the group's first consolidated return year ending after the date of the acquisition, with the internal revenue officer with whom such return is required to be filed.

* * * * *

Because this Treasury decision will not be detrimental to any taxpayer, it

[1] 34 F.R. 15556

is found that it is unnecessary to issue this Treasury decision with notice and public procedure thereon under section 553(b) of Title 5 of the United States Code or subject to the effective date limitation of section 553(d) of such Title.

(This Treasury decision is issued under the authority contained in sections 1502 and 7805 of the Internal Revenue Code of 1954 (68A Stat. 367, 917; 26 U.S.C. 1502, 7805).)

RANDOLPH W. THROWER,
Commissioner of Internal Revenue.

Approved October 2, 1969.

EDWIN S. COHEN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on Oct. 6, 1969, 8:48 a.m., and published in the issue of the Federal Register for Oct. 7, 1969, 34 F.R. 15556)

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26 CFR 1.1502–79: Separate return years. (Also Section 172; 1.172–1.)

A consolidated net operating loss incurred in a year governed by regulations for taxable years beginning after December 31, 1965, attributable to a subsidiary not in existence prior to the loss year, may be carried back to the parent's separate return year for 1965.

Rev. Rul. 69–623

Advice has been requested whether a consolidated net operating loss can be carried back to offset the gains of the parent corporation in a separate return year under the circumstances described below.

X corporation, incorporated in 1965, filed a separate return for its taxable year ended December 31, 1965, reporting taxable income of 10*x* dollars. *X* corporation formed *Y* corporation on January 1, 1966, and acquired all of *Y*'s stock. *X* and *Y* corporation filed a consolidated return for the calendar year ended December 31, 1966, reflecting a consolidated net operating loss of 10*x* dollars. This loss was entirely attributable to *Y*.

The specific question is whether the consolidated net operating loss of 10*x* dollars generated by *Y* can be used to offset the 10*x* dollars earned by *X* during a separate return year that commenced prior to December 31, 1965, a year in which *Y* was not in existence.

Section 1.1502–79 of the Income Tax Regulations, applicable to taxable years beginning after December 31, 1965, provides, in part, as follows:

> (a) Carryover and carryback of consolidated net operating losses to separate return years.—(1) In general. (i) If a consolidated net operating loss can be carried under the principles of section 172(b) and paragraph (b) of section 1.1502–21 to a separate return year of a corporation (or could have been so carried if such corporation were in existence) which was a member in the year in which such loss arose, then the portion of such consolidated net operating loss attributable to such corporation (as determined under subparagraph (3) of this paragraph) shall be apportioned to such corporation (and any successor to such corporation in a transaction to which section 381(a) applies) and shall be a net operating loss carryover or carryback to such separate return year; accordingly, such portion shall not be included in the consolidated net operating loss carryovers or carrybacks to the equivalent consolidated return year. * * *
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> (2) Nonapportionment to certain members not in existence. Notwithstanding subparagraph (1) of this paragraph, the portion of a consolidated net operating loss attributable to a member shall not be apportioned to a prior separate return year for which such member was not in existence and shall be included in the consolidated net operating loss carrybacks to the equivalent consolidated return year of the group (or, if such equivalent year is a separate return year, then to such separate return year), provided that such member was a member of the group immediately after its organization.

In the case of *Trinco Industries, Inc.* v. *Commissioner,* 22 T.C. 959 (1954), the Tax Court of the United States held that under the consolidated return regulations applicable to taxable years beginning before January 1, 1966, a consolidated net operating loss entirely attributable to one member of an affiliated group must be allocated to that member if it filed a separate return for the carryback year but, if it was not in existence in the carryback year, such a loss could not be carried back by another member of the group to its separate return year.

However, for taxable years beginning after December 31, 1965, section 1.1502–79 of the regulations permits a loss attributable to a member that was not in existence in the carryback year to be used by the group or another member provided that such member was a member of the group immediately after its organization. If a consolidated return was filed for the equivalent carryback year, section 1.1502–79 of the regulations provides that the loss shall be included in the consolidated net operating loss carryback of the group. On the other hand, if a separate instead of a consolidated return was filed for the equivalent carryback year, then the loss shall be carried to such separate return year.

Where a consolidated net operating loss is incurred in a year governed by the consolidated return regulations applicable to taxable years beginning after December 31, 1965, those regulations are applicable in determining both the amount of such loss that may be carried back to a prior taxable year as well as the member or members who can carry back the loss to prior taxable years notwithstanding that the prior taxable years began before the effective date of the new consolidated return regulations. However, in computing the net operating loss deduction for the prior taxable years the necessary computations are to be made under the law relating to such years. (See *Herbert J. Kent* v. *Commissioner,* 35 T.C. 30 (1960).)

Accordingly, in the instant case, since the consolidated net operating loss was incurred in a year governed by the consolidated return regulations applicable to taxable years beginning after December 31, 1965, it must be used by *X* corporation as a net operating loss carryback to 1965 and deducted under the provisions of section 172 of the Code.

Section 1504.—Definitions

26 CFR 1.1504–1: Definitions.

When a common parent elects to file a consolidated return with a sub-

sidiary that it organized, incorporated, manages and controls, an affiliation occurs at the date of subsidiary's incorporation notwithstanding its failure to issue stock certificate to the parent; G.C.M. 2019 superseded.

Rev. Rul. 69–591 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in G.C.M. 2019, C.B. VI–2, 128 (1927).

The question presented is whether an "affiliated group," within the meaning of section 1504(a) of the Internal Revenue Code of 1954, exists under the circumstances described below.

M, a domestic corporation, organized and incorporated domestic subsidiary *O* for the purpose of having *O* act as its sales agent. *O* immediately commenced business by selling to customers products manufactured by *M*. *O* did not issue capital stock to *M* but was managed and controlled by *M*. *M* as common parent elected to file a consolidated return, with the consent of *O*, for the current taxable year.

Section 1504(a) of the Code provides, in pertinent part, that the term "affiliated group" means one or more chains of includible corporations connected through stock ownership with a common parent corporation that is an includible corporation if stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of nonvoting stock of each of the includible corporations (except the common parent corporation) is owned directly by one or more of the other includible corporations.

The term "stock" as used in consolidated return provisions is not restricted to cases where formal certificates have been issued, but is considered as having the meaning of "shares of stock," i.e., the right which the owner or owners have in the management, profits, and ultimate assets of a corporation.

All of the rights attributable to stock ownership in *O* were vested in *M* from the date of incorporation of *O*. These rights actually were exercised in the management and operation of *O* by *M*.

Accordingly, *M* and *O* should be treated as an affiliated group as defined under the provisions of section 1504(a) of the Code notwithstanding the failure of *O* to issue stock certificate to *M*. The affiliation occurred at the date of incorporation of *O*.

G.C.M. 2019 is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

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26 CFR 1.1504–1: Definitions.

Federal income tax and interest equalization tax consequences of an "overseas financing" arrangement. See Rev. Rul. 69–377, page 231.

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26 CFR 1.1504–1: Definitions.

New affiliated group changes from overall limitation on foreign tax credit to per-country limitation. See Rev. Rul. 69–518, page 154.

Subtitle B—Estate and Gift Taxes

Chapter 11—Estate Tax

Subchapter A. Estates of Citizens or Residents

Part III—Gross Estate

Section 2031.—Definition of Gross Estate

26 CFR 20.2031–1: Definition of gross estate; valuation of property.
(Also Section 6601; 301.6601–1.)

Valuation and redemption date of marketable Treasury bonds, owned by a decedent, that may be redeemed in payment of Federal estate tax; Revenue Ruling 156 superseded in part.

Rev. Rul. 69–489

Advice has been requested as to valuation, for Federal estate tax purposes, of marketable United States Treasury bonds owned by a decedent under the circumstances described below.

The taxpayer died owning certain marketable, interest-bearing United States Treasury bonds that could be redeemed at the option of the representatives of his estate at par value plus accrued interest to the date of payment, for the payment of Federal estate taxes. The mean between the highest and lowest quoted selling price of the bonds at the date of death was less than their par value. The amount of the estate tax exceeded the par value of the bonds.

Section 2031(a) of the Internal Revenue Code of 1954 provides that the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated. Section 20.2031–1(b) of the Estate Tax Regulations provides, in part, that the value of every item of property includible in a decedent's gross estate is its fair market value at the time of the decedent's death.

In *Bankers Trust Company* v. *United States*, 284 F. 2d 537 (1960), it was held that where United States Treasury bonds could be used in payment of estate taxes their value for Federal estate tax purposes was at least par value and where the bonds could not be so used the value was the market price. In this case the bonds could be applied in payment of Federal estate tax and the Court specifically concluded that they were includible in the gross estate at par value because the market price of the bonds at the date of death did not exceed par value.

To the extent marketable United States Treasury bonds owned at death may be applied at par in payment of Federal estate taxes the par value thereof or the mean between their highest and lowest quoted selling price at the time of his death (and accrued interest to the date of death), whichever is higher, constitutes their "value"

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

or "fair market value" within the above cited Code and regulations. Such bonds are, therefore, includible at such value in a decedent's gross estate for Federal estate tax purposes. As to bonds in excess of the amount which may be so applied, such mean quoted selling price thereof (and accrued interest to the date of death) will be the value at which they are includible in a decedent's gross estate for Federal estate tax purposes.

Accordingly, in the instant case it is held that the described bonds of the decedent are includible in the value of his gross estate at par value plus interest accrued to the date of death.

Revenue Procedure 69–18, page 300, this Bulletin, announces procedures for the redemption of certain Treasury bonds in connection with the payment of Federal estate tax, pursuant to instructions issued by the Bureau of the Public Debt.

Except in the case of redemption by substitution, the effective redemption date described in Revenue Procedure 69–18 shall be considered the date the payment is made for purposes of section 6601(a) of the Code. In the case of redemption by substitution (see section 6 of Revenue Procedure 69–18), the date of payment is the date the estate tax was paid other than by use of eligible Treasury bonds.

This Revenue Ruling supersedes that part of Revenue Ruling 156, C.B. 1953–2, 253, covering the valuation of certain Treasury bonds.

Section 2036.—Transfers With Retained Life Estate

26 CFR 20.2036–1: Transfers with retained life estate.

Where property held in tenancy by the entirety is transferred to a trust under which each spouse reserves a joint and survivor life estate, only one-half of the value of the trust property is includible in each cotenant's gross estate; Revenue Ruling 57–448 revoked.

Rev. Rul. 69–577

Revenue Ruling 57–448, C.B. 1957–2, 618, holds that where property purchased by the husband and held in tenancy by the entirety was transferred in trust to pay one-half of the income therefrom to each spouse during their joint lives and the entire income to the survivor for life, the entire value of the trust property, less the value of the widow's outstanding life estate in one-half thereof, is includible in the gross estate of the husband, under section 2036(a)(1) of the Internal Revenue Code of 1954.

In *United States* v. *Heasty,* 370 F. 2d 525 (1966), the court concluded that since under local law each cotenant had a one-half interest in property held in joint tenancy, each made a transfer of a one-half interest when such property was placed in trust. Consequently, only one-half of the value of the trust property was includible in the purchaser's gross estate under section 2036(a)(1) of the Code, on the basis of the retained joint and survivor life estate therein.

If under the local law each spouse is entitled to one-half of the income from property held in tenancy by the entirety, the cotenant's interest in the property is essentially the same as that in a joint tenancy. Under such circumstances it is held that only one-half of the value of the trust property is includible in each cotenant's gross estate under section 2036(a)(1) of the Code.

Revenue Ruling 57–448 is hereby revoked.

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26 CFR 20.2036–1: Transfers with retained life estate.

Application of the "reciprocal trust" doctrine requires only that the trusts be interrelated, and that the arrangement, to the extent of mutual value, leaves the settlors in approximately the same economic position as they would have been in had they created trusts naming themselves as life beneficiaries.

Ct.D. 1927

SUPREME COURT OF THE UNITED STATES

No. 574.—October Term, 1968

United States, Petitioner

v.

Estate of Joseph P. Grace, Deceased, et al.

[395 U.S. 316]

On writ of certiorari to the United States Court of Claims

[June 2, 1969]

Mr. JUSTICE MARSHALL delivered the opinion of the Court.

This case involves the application of § 811(c)(1)(B) of the Internal Revenue Code of 1939 [recodified as section 2036 of the 1954 Code] to a so-called "reciprocal trust" situation.[1] After Joseph P. Grace's death in 1950, the Commissioner of Internal Revenue determined that the value of a trust created by his wife was includible in his gross estate. A deficiency was assessed and paid, after denial of a claim for a refund, this refund suit was brought. The Court of Claims, with two judges dissenting, ruled that the value of the trust was not includible in

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[1] Section 811(c)(1)(B) provided that—

"The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property . . .

. . . . . .

"(c) . . .

"(1) *General rule.* 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—

. . . . . .

"(B) 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 (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom . . . ."

Section 811(c)(1)(B) has been recodified as § 2036 of the Internal Revenue Code of 1954, 26 U.S.C. §2036.

decedent's estate under § 811(c)(1)(B) and entered judgment for respondent. *Estate of Joseph P. Grace* v. *United States,* 183 Ct. Cl. 745, 393 F. 2d 939 (1968). We granted certiorari because of an alleged conflict between the decisions below and certain decisions in the Courts of Appeals and because of the importance of the issue presented to the administration of the federal estate tax laws. 393 U.S. 975 (1968). *We reverse.*

I.

Decedent was a very wealthy man at the time of his marriage to the late Janet Grace in 1908. Janet Grace had no wealth or property of her own, but between 1908 and 1931, decedent transferred to her a large amount of personal and real property, including the family's Long Island estate. Decedent retained effective control over the family's business affairs, including the property transferred to his wife. She took no interest and no part in business affairs and relied upon her husband's judgment. Whenever some formal action was required regarding property in her name, decedent would have the appropriate instrument prepared and she would execute it.

On December 15, 1931, decedent executed a trust instrument, hereinafter called the Joseph Grace trust. Named as trustees were decedent, his nephew, and a third party. The trustees were directed to pay the income of the trust to Janet Grace during her lifetime, and to pay to her any part of the principal which a majority of the trustees might deem advisable. Janet was given the power to designate, by will or deed, the manner in which the trust estate remaining at her death was to be distributed among decedent and their children. The trust properties included securities and real estate interests.

On December 30, 1931, Janet Grace executed a trust instrument, hereinafter called the Janet Grace trust, which was virtually identical to the Joseph Grace trust. The trust properties included the family estate and corporate securities, all of which had originally been transferred to her by decedent in preceding years.

The trust instruments were prepared by one of decedent's employees in accordance with a plan devised by decedent to create additional trusts before the advent of a new gift tax expected to be enacted the next year. Decedent selected the properties to be included in each trust. Janet Grace, acting in accordance with this plan, executed her trust instrument at decedent's request.

Janet Grace died in 1937. The Joseph Grace trust terminated at her death. Her estate's federal estate tax return disclosed the Janet Grace trust and reported it as a nontaxable transfer by Janet Grace. The Commissioner asserted that the Janet and Joseph Grace trusts were "reciprocal" and asserted a deficiency to the extent of mutual value. Compromises on unrelated issues resulted in 55% of the smaller of the two trusts, the Janet Grace trust, being included in her gross estate.

Joseph Grace died in 1950. The federal estate tax return disclosed both trusts. The Joseph Grace trust was reported as a nontaxable transfer and the Janet Grace trust was reported as a trust under which decedent held a limited power of appointment. Neither trust was included in decedent's gross estate.

The Commissioner determined that the Joseph and Janet Grace trusts were "reciprocal" and included the amount of the Janet Grace trust in decedent's gross estate. A deficiency in the amount of $363,500.97, plus interest, was assessed and paid.

II.

Section 811(c)(1)(B) of the Internal Revenue Code of 1939 provided that certain transferred property in which a decedent retained a life interest was to be included in his gross estate. The general purpose of the statute was to include in a decedent's gross estate transfers that are essentially testamentary—*i.e.,* transfers which leave the transferor a significant interest in or control over the property transferred during his lifetime. See *Commissioner* v. *Estate of Church,* 335 U.S. 632, 643–644 (1949) [Ct. D. 1710, C.B. 1949–1, 212].

The doctrine of reciprocal trusts was formulated in response to attempts to draft instruments which seemingly avoid the literal terms of § 811(c)(1)(B), while still leaving the decedent the lifetime enjoyment of his property.[2] The doctrine dates from *Lehman* v. *Commissioner,* 109 F. 2d 99 (C.A. 2d Cir.), cert. denied, 310 U.S. 637 (1940). In *Lehman,* decedent and his brother owned equal shares in certain stocks and bonds. Each brother placed his interest in trust for the other's benefit for life, with remainder to the life tenant's issue. Each brother also gave the other the right to withdraw $150,000 of the principal. If the brothers had each reserved the right to withdraw $150,000 from the trust that each had created, the trusts would have been includible in their gross estates as interests of which each had made a transfer with a power to revoke. When one of the brothers died, his estate argued that neither trust was includible because the decedent did not have a power over a trust which he had created.

The Second Circuit disagreed. That court ruled that the effect of the transfers was the same as if the decedent had transferred his stock in trust for himself, remainder to his issue, and had reserved the right to withdraw $150,000. The court reasoned:

"The fact that the trusts were reciprocated or 'crossed' is a trifle, quite lacking in practical or legal significance. . . . The law searches out the reality and is not concerned with form." 109 F. 2d, at 100.

The court ruled that the decisive point was that each brother caused the other to make a transfer by establishing his own trust.

[2] See Colgan & Molloy, Converse Trusts—The Rise and Fall of a Tax Avoidance Device, 3 Tax. L. Rev. 271 (1948).

The doctrine of reciprocal trusts has been applied numerous times since the *Lehman* decision.[3] It received congressional approval in § 6 of the Technical Changes Act of 1949, c. 720, 63 Stat. 893.[4] The present case is, however, this Court's first examination of the doctrine.

The Court of Claims was divided over the requirements for application of the doctrine to the situation of this case. Relying on some language in *Lehman* and certain other Courts of Appeals' decisions,[5] the majority held that the crucial factor was whether the decedent had established his trust as consideration for the establishment of the trust of which he was a beneficiary. The court ruled that decedent had not established his trust as a *quid pro quo* for the Janet Grace trust, and that Janet Grace had not established her trust in exchange for the Joseph Grace trust. Rather, the trusts were found to be part of an established pattern of family giving, with neither party desiring to obtain property from the other. Indeed, the court found that Janet Grace had created her trust because decedent requested that she do so. It therefore found the reciprocal trust doctrine inapplicable.

The court recognized that certain cases had established a slightly different test for reciprocity.[6] Those cases inferred consideration from the establishment of two similar trusts at about the same time. The court held that any inference of consideration was rebutted by the evidence in the case, particularly the lack of any evidence of an estate tax avoidance motive on the part of the Graces. In contrast, the dissent felt that the majority's approach placed entirely too much weight on subjective intent. Once it was established that the trusts were interrelated, the dissent felt that the subjective intent of the parties in establishing the trusts should become irrelevant. The relevant factor was whether the trusts created by the settlors placed each other in approximately the same objective economic position as they would have been in if each had created his own trust with himself, rather than the other, as life beneficiary.

We agree with the dissent that the approach of the Court of Claims majority places too much emphasis on the subjective intent of the parties in creating the trusts and for that reason hinders proper application of the federal estate tax laws. It is true that there is language in *Lehman* and other cases that would seem to support the majority's approach. It is also true that the results in some of those cases arguably support the decision below.[7] Nevertheless, we think that these cases are not in accord with this Court's prior decisions interpreting related provisions of the federal estate tax laws.

Emphasis on the subjective intent of the parties in creating the trusts, particularly when those parties are members of the same family unit, creates substantial obstacles to the proper application of the federal estate tax laws. As this Court said in *Estate of Spiegel* v. *Commissioner,* 335 U.S. 701, 705–706 (1949) [Ct.D. 1711, C.B. 1949–1, 220]:

"Any requirement . . . [of] a post-death attempt to probe the settlor's thought in regard to the transfer, would partially impair the effectiveness of . . . [section 811(c)] as an instrument to frustrate estate tax evasions."

We agree that "the taxability of a trust corpus . . . does not hinge on a settlor's motives, but depends upon the nature and operative effect of the trust transfer." *Id.,* 335 U.S., at 705. See also *Commissioner* v. *Estate of Church, supra.*

We think these observations have particular weight when applied to the reciprocal trust situation. First, inquiries into subjective intent, especially in interfamily transfers, are particularly perilous. The present case illustrates that it is, practically speaking, impossible to determine after the death of the parties what they had in mind in creating trusts over 30 years earlier. Second, there is a high probability that such a trust arrangement was indeed created for tax-avoidance purposes. And, even if there was no estate-tax-avoidance motive, the settlor in a very real and objective sense did retain an economic interest while purporting to give away his property.[8] Finally, it is unrealistic to assume that the settlors of the trusts, usually members of one family unit, will have created their trusts as a bargained-for exchange for the other trust. "Consideration," in the traditional legal sense, simply does not normally enter into such interfamily transfers.[9]

For these reasons, we hold that application of the reciprocal trust doctrine is not dependent upon a finding that each trust was created as a *quid pro quo* for the other. Such a "consideration" requirement necessarily involves a difficult inquiry into the subjective intent of the settlors. Nor do we think it necessary to prove the existence of a tax-avoidance motive. As we have said above, standards of this sort, which rely on subjective factors, are rarely workable under the federal estate tax laws. Rather, we hold that application

[3] See, *e.g., Glaser* v. *United States,* 306 F. 2d 57 (C.A. 7th Cir. 1962); *Estate of Moreno* v. *Commissioner,* 260 F. 2d 389 (C.A. 8th Cir. 1958); *Hanauer's Estate* v. *Commissioner,* 149 F. 2d 857 (C.A. 2d Cir.), cert. denied, 326 U.S. 770 (1945); *Cole's Estate* v. *Commissioner,* 140 F. 2d 636 (C.A. 8th Cir. 1944).

[4] See S. Rep. No. 831, 81st Cong., 1st Sess., 5–6 (1949) [C.B. 1949–2, 289]; H.R. Rep. No. 920, 81st Cong., 1st Sess., 5 (1949) [C.B. 1949–2, 285].

[5] See *McLain* v. *Jarecki,* 232 F. 2d 211 (C.A. 7th Cir. 1956); *Newberry's Estate* v. *Commissioner,* 201 F. 2d 874 (C.A. 3d Cir. 1953); *In re Lueder's Estate,* 164 F. 2d 128 (C.A. 3d Cir. 1947).

[6] *E.g., Orvis* v. *Higgins,* 180 F. 2d 537 (C.A. 2d Cir.), cert. denied, 340 U.S. 810 (1950).

[7] See cases cited in n. 5, *supra.*

[8] For example, in the present case decedent ostensibly devised the trust plan to avoid an imminent federal gift tax. Instead of establishing trusts for the present benefit of his children, he chose an arrangement under which he and his wife retained present enjoyment of the property and under which the property would pass to their children without imposition of either estate or gift tax.

[9] The present case is probably typical in this regard. Janet Grace created her trust because decedent requested that she do so; it was in no real sense a bargained-for *quid pro quo* for his trust. See also *Hanauer's Estate* v. *Commissioner, supra,* n. 3.

of the reciprocal trust doctrine requires only that the trusts be interrelated, and that the arrangement, to the extent of mutual value, leaves the settlors in approximately the same economic position as they would have been in had they created trusts naming themselves as life beneficiaries.[10]

Applying this test to the present case, we think it clear that the value of the Janet Grace trust fund must be included in decedent's estate for federal estate tax purposes. It is undisputed that the two trusts are interrelated. They are substantially identical in terms and were created at approximately the same time. Indeed, they were part of a single transaction designed and carried out by decedent. It is also clear that the transfers in trust left each party, to the extent of mutual value, in the same objective economic position as before. Indeed, it appears, as would be expected in transfers between husband and wife, that the effective position of each party *vis-à-vis* the property did not change at all. It is no answer that the transferred properties were different in character. For purposes of the estate tax, we think that economic value is the only workable criterion. Joseph Grace's estate remained undiminished to the extent of the value of his wife's trust and the value of his estate must accordingly be increased by the value of that trust.

The judgment of the Court of Claims is reversed and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

Mr. Justice Stewart took no part in the consideration or decision of this case.

Mr. Justice Douglas dissenting in a separate opinion.

[10] We do not mean to say that the existence of "consideration," in the traditional legal sense of a bargained-for exchange, can never be relevant. In certain cases, inquiries into the settlor's reasons for creating the trusts may be helpful in establishing the requisite link between the two trusts. We only hold that a finding of a bargained-for consideration is not necessary to establish reciprocity.

Section 2041.—Powers of Appointment

26 CFR 20.2041–1: Powers of appointment; in general.

Redemption under section 303 of the Code of property includible in an estate under a general power of appointment. See Rev. Rul. 69–616, page 45.

Part IV—Taxable Estate

Section 2053.—Expenses, Indebtedness, and Taxes

26 CFR 20.2053–3: Deduction for expenses of administering estate.

Post-death interest on Federal and State income tax deficiencies incurred while an executor of a decedent's estate was contesting imposition of the taxes is deductible as an administration expense under section 2053(a)(2) of the Code to the extent allowable under local law.

Rev. Rul. 69–402

Advice has been requested whether interest on income tax deficiencies, which accrued after a decedent's death and was paid by the executor of his estate, is deductible under section 2053 (a) (2) of the Internal Revenue Code of 1954 as an administration expense.

At the time of the decedent's death, his Federal income tax returns for prior years had been audited and a tax deficiency proposed. The decedent died while still in disagreement as to the amount of the assessment of the proposed deficiency. After contesting the proposed deficiency, the executor of the estate reached a settlement agreeing to an assessment in an amount that included interest accruing after the decedent's death. In addition, the executor paid to the state in which decedent resided at the time of his death, an income tax deficiency and post-death interest thereon that resulted from adjustments in the Federal income tax liability. Under the laws of that state reasonable and necessary expenses actually paid by an executor are allowable by the court on the settlement of his account.

Section 2053(a)(2) of the Code provides that the value of the taxable estate is determined by deducting from the value of the gross estate such amounts as are paid out for administration expenses provided that the expenses are allowable by the law of the jurisdiction where the estate is being administered. In defining "administration expenses," section 20.2053–3 of the Estate Tax Regulations limits the term to:

* * * such expenses as are actually and necessarily incurred in the administration of the decedent's estate; that is, in the collection of assets, payment of debts, and distribution of property to the persons entitled to it. The expenses contemplated in the law are such only as attend the settlement of an estate and the transfer of the property of the estate to individual beneficiaries or to a trustee * * *

In *Robert D. Maehling* v. *United States*, 20 AFTR 2d 5997 (1967), 67–2 USTC par. 12,486, it was held that interest on a Federal income tax deficiency that accrued after the decedent's death was an allowable expense under state law and therefore was a deductible expense under section 2053 (a) of the Code, not as a claim against the estate, but as an administration expense. The court in *Maehling* based its conclusion on the fact that under applicable state law the executor has a duty to contest the imposition of additional taxes if he could do so in good faith; therefore, he properly permitted interest to accrue while he contested for the benefit of the estate the claim for additional income taxes by the Federal Government.

It is held that the post-death interest on Federal and State income tax deficiencies incurred while the executor of the decedent's estate was contesting imposition of the taxes is deductible as an administration expense under section 2053(a)(2) of the Code to the extent allowable under local law. However, the estate may waive the right to deduct the interest on its Federal estate tax return in order to deduct it on the

fiduciary income tax return as provided by section 642(g) of the Code.

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26 CFR 20.2053–3: Deduction for expenses of administering estate.

Attorney's fees paid to an executor-attorney, serving in a dual capacity, for legal services found to be extraordinary by court order are allowable as a deduction from the gross estate of a Wisconsin decedent.

Rev. Rul. 69–551

Advice has been requested as to the allowance of a deduction for the fees paid by the estate of a Wisconsin decedent under the circumstances described below.

The executor of the estate also acted in the capacity of attorney. He received for services as executor an amount that included 13*x* dollars as compensation for legal services. The executor obtained an order from the county court in which the court found the legal services to be extraordinary services within the meaning of section 317.08, Wisconsin Statutes (1959), and reasonable in amount. There was no evidence of clear abuse of discretion by the county court in approving the attorney fees.

In computing the value of the taxable estate, section 2053(a)(2) of the Internal Revenue Code of 1954 allows as a deduction from the value of a decedent's gross estate, such amounts for administration expenses as are allowable by the laws of the jurisdiction under which the estate is being administered.

It is the general rule of law in Wisconsin that where a lawyer becomes executor or administrator, his compensation as such is in full for his services, although he exercises his professional skill therein; even if he performs duties that he might properly have hired an attorney to perform, he is not entitled to attorney's fees. The rule is one of public policy grounded upon the principle that a fiduciary shall not place himself in a situation where his interests conflict with his duty as fiduciary. *In re Fehlhaber's Will,* 272 Wis. 327, 75 N.W. 2d 444 (1956).

However, section 317.08, Wisconsin Statutes (1959), provides that, in addition to his per diem and commission, an executor or administrator should be allowed such further sum, in cases of unusual difficulty or extraordinary services, as the county court should judge reasonable. While the compensation for extraordinary services should be based upon evidence presented in sufficient detail to afford interested parties an opportunity to oppose the same, in the absence of such evidence the approval of fees by the county court will not be set aside unless there is clearly an abuse of discretion. *In re Astrach's Estate,* 25 Wis. 2d 331, 130 N.W. 2d 878 (1964).

Under the circumstances of the instant case it is held that the value of the decedent's estate may be reduced for Federal estate tax purposes by the entire amount paid to the executor-attorney for services rendered as executor, including the 13*x* dollars paid for extraordinary services pursuant to the order of the local court. These amounts are deductible as administration expenses under section 2053(a)(2) of the Code.

Section 2054.—Losses

26 CFR 20.2054–1: Deduction for losses from casualties or thefts.
(Also Section 166; 1.166–1.)

No deduction is allowable under section 2054 of the Code to an estate by reason of the executor's inability to recover from the insurance beneficiary an amount equal to his pro rata share of the estate tax liability; a legatee whose share of the estate bears the burden of the tax attributable to such insurance proceeds is entitled to a bad debt deduction under section 166 (d)(1).

Rev. Rul. 69–411

Advice has been requested regarding the deductibility of an amount equal to a portion of the Federal estate tax for purposes of computing a decedent's taxable estate, or for purposes of computing a legatee's taxable income, under the circumstances described below.

The decedent, a United States citizen, died testate. His adjusted gross estate, valued at $300,000, consisted of $250,000 of probate property that passed under his will to *A,* and $50,000 of insurance proceeds that passed to *B* as the named beneficiary of a policy of life insurance on the decedent's life. The decedent's will contained no directions with respect to the payment of the Federal estate tax.

Shortly after the death of the decedent, but before the probate of his will and the appointment of the executor of his estate, the insurance company paid the proceeds of the policy of insurance to *B. B* then quit his job, dissipating the insurance proceeds at a gambling casino. Through his own negligence he severely and permanently injured himself. *B* is presently a charity patient at a State Hospital, and the medical prognosis is that he will never be able to work again.

In connection with the preparation of the decedent's Federal estate tax return (Form 706), the executor sought to recover a portion of the estate tax liability from *B,* but was unsuccessful (*B* having no collectible assets) with the result that the entire amount must be borne by *A* out of his share of the estate. The specific questions presented are whether the executor may compute the taxable estate by claiming a deduction under section 2054 of the Internal Revenue Code of 1954 for the portion of the estate tax attributable to the value of the insurance proceeds included in the gross estate; and, if not allowable, whether *A,* in computing his taxable income, may claim the deduction under section 166 of the Code. The portion of the estate tax attributable to the included value of the insurance proceeds is $9,850, determined as follows: $50,000 (insurance proceeds) ÷ $300,000 (taxable estate plus specific exemption) × $59,100 (net Federal estate tax) = $9,850 (por-

tion of estate tax attributable to insurance proceeds).

Section 2002 of the Code imposes the liability for payment of the Federal estate tax upon the executor of the decedent's estate. Section 20.2002–1 of the Estate Tax Regulations, provides as follows:

> The Federal estate tax imposed both with respect to the estate of citizens or residents and with respect to estates of nonresidents not citizens is payable by the executor or administrator of the decedent's estate. This duty applies to the entire tax, regardless of the fact that the gross estate consists in part of property which does not come within the possession of the executor or administrator. If there is no executor or administrator appointed, qualified and acting in the United States, any person in actual or constructive possession of any property of the decedent is required to pay the entire tax to the extent of the value of the property in his possession.

Section 2206 of the Code provides as follows:

> Unless the decedent directs otherwise in his will, if any part of the gross estate on which tax has been paid consists of proceeds of policies of insurance on the life of the decedent receivable by a beneficiary other than the executor, the executor shall be entitled to recover from such beneficiary such portion of the total tax paid as the proceeds of such policies bear to the sum of the taxable estate and the amount of the exemption allowed in computing the taxable estate, determined under section 2051. If there is more than one such beneficiary, the executor shall be entitled to recover from such beneficiaries in the same ratio. In the case of such proceeds receivable by the surviving spouse of the decedent for which a deduction is allowable under section 2056 (relating to marital deduction), this section shall not apply to such proceeds except as to the amount thereof in excess of the aggregate amount of the marital deductions allowed under such section.

Section 2054 of the Code provides that for purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate losses incurred during the settlement of estates arising from fires, storms, shipwrecks, or other casualties, or from theft, when such losses are not compensated for by insurance or otherwise.

Losses which are not of the nature described are not deductible under section 2054. Section 20.2054–1 of the Estate Tax Regulations. That the loss in the instant case is not a casualty loss may be illustrated by reference to the Code sections pertaining to the Federal income tax. Section 165(c)(3) of the Code provides for deductions for casualty and theft losses in terms similar to those in section 2054. Specific reference is made to fires, storms, shipwrecks, or other casualties to indicate the type of loss that is deductible. The worthlessness of the executor's right to recover a portion of the estate tax from the insurance beneficiary is not a loss of the character described in section 2054 or 165 of the Code, nor is it a theft. Rather, it is in the nature of a bad debt. For income tax purposes, losses arising from bad debts are deductible under section 166 of the Code, entirely separate from the casualty loss provisions of section 165(c)(3) of the Code. This separate treatment indicates that bad debts, such as in the instant case, were not intended to be classified as casualty losses or thefts in section 2054 of the Code.

Accordingly, no estate tax deduction is allowable under section 2054 of the Code by reason of the executor's inability to recover from the insurance beneficiary the amount equal to his pro rata share of the estate tax liability.

Section 2206 of the Code effects a limited apportionment of the Federal estate tax liability pursuant to the legal doctrine of "equitable apportionment," which is a specific application of the equitable concept of contribution. The doctrine is grounded on the premise that persons having a common interest in property, or a common burden, should bear in proportion any obligation imposed thereon, or any such common burden. While the payment of the estate tax is the immediate responsibility of the executor, all of the assets comprising the decedent's gross estate, including nonprobate assets, are subject to a lien for unpaid taxes. Sections 2002 and 6324 of the Code. Similarly, each of the persons receiving property from the decedent that is included in the gross estate is personally liable, to the extent of the value of such property at the date of decedent's death, for any unpaid tax. Section 6324 of the Code.

Section 166(d)(1) of the Code provides that a nonbusiness bad debt is deductible as a short term capital loss in the year in which such nonbusiness bad debt becomes worthless. Section 166(d)(2) defines a nonbusiness bad debt as a debt other than (1) a debt created or acquired in connection with the taxpayer's trade or business, or (2) a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business.

As provided in section 1.166–1(d) of the Income Tax Regulations, only a bona fide debt qualifies for purposes of section 166. A bona fide debt is defined in that section of the regulations as a debt which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money. Furthermore, this bona fide debtor-creditor relationship must have been intended to be created by the parties to the transaction or must arise by operation of law.

In the situation described, the payment of the Federal estate tax attributable to the inheritance of *B* out of property inherited by *A* entitled *A* to be subrogated to the executor's claim against *B* who then, by operation of law, became a creditor of *B*. Accordingly, *A* is entitled to a bad debt deduction under the provisions of section 166(d)(1) of the Code in the year he acquired the debt, which was also the year it became worthless.

The fact that there was never any reasonable possibility of *A* being reimbursed by *B* for the payment is irrelevant in considering the deductibility of the amount inasmuch as the debtor-creditor relationship between *A* and *B* arose involuntarily on the part of *A*. See *Haywood P. Martin* v. *Commissioner,* 38 T.C. 188 (1962), acquiescence, C.B. 1963–1, 4.

Subchapter B. Estates of Nonresidents Not Citizens

Section 2105.—Property Without the United States

26 CFR 20.2105–1: Estates of nonresidents not citizens; property without the United States.

Special funds deposited in a bank in the United States by or for a nonresident alien and held by such bank as fiduciary are treated as property within the United States; G.C.M. 22419 superseded.

Rev. Rul. 69–596 [1]

The purpose of this Revenue Ruling is to update and restate under the current statute and regulations the position set forth in G.C.M. 22419, C.B. 1940–2, 288. This ruling relates to whether funds placed with a bank within the United States by or for a nonresident not a citizen of the United States and held by such bank as trustee or as custodian are considered "deposits with persons carrying on the banking business" in determining the situs of such property for Federal estate tax purposes.

Section 2105(b) of the Internal Revenue Code of 1954, as amended by P.L. 89–809 (Foreign Investors Tax Act of 1966), C.B. 1966–2, 656, relating to property without the United States, provides:

> Certain Bank Deposits, Etc.—For purposes of this subchapter—
> (1) amounts described in section 861(c) if any interest thereon, were such interest received by the decedent at the time of his death, would be treated by reason of section 861(a)(1)(A) as income from sources without the United States, * * * shall not be deemed property within the United States.

Section 861(c) of the Code, referred to in section 2105(b), relating to income from sources within the United States includes "deposits with persons carrying on the banking business."

Deposits with a bank are either general or special. A general deposit consists of money paid to a bank for the convenience of the depositor and to his general credit to be repaid in current funds on his order or demand. Title to the money passes to the bank, and the money is mingled with the bank's general funds and used in the banking business. The relationship of debtor and creditor is created by such a deposit. The deposits to which section 2105(b) refers are those general deposits to which the owner has substantially unrestricted access, such as in ordinary checking and savings accounts (including certificates of deposit) available at most banks.

A special deposit is made where property (including money) is delivered to a bank for the purpose of having it safely kept and the identical property deposited is to be returned to the depositor, or where the property delivered to the bank is for some specific purpose not contemplating a credit or general account. In the case of the special deposit, the property deposited may not be commingled with other funds or assets of the bank and used in the banking business, and with respect to it a fiduciary relationship, of either principal and agent, bailor and bailee, trustee and cestui que trust, or a combination of such relationships, is created between the bank and the depositor.

Funds that are held by a bank as trustee or as custodian acting in a fiduciary capacity do not come within the scope of section 2105(b). The beneficiary's claim to these moneys is usually restricted in some manner, such as by the trustee bank's power to approve or disapprove any distribution of the funds to him. "A deposit so hedged about with restrictions is not properly a bank deposit at all; at least there is no reason to suppose that it is within the scope of * * * [the predecessor of section 2105(b) of the 1954 Code]." *City Bank Farmers Trust Co.* v. *Pedrick,* 168 F. 2d 618, 620 (1948), certiorari denied, 335 U.S. 898 (1948). See also *Estate of Fredericka Lowenstein* v. *Commissioner,* 17 T.C. 60 (1951).

Therefore, funds placed with a bank within the United States by or for a nonresident not a citizen of the United States and held by such bank as fiduciary do not constitute "deposits with persons carrying on the banking business." Accordingly, they are treated as property within the United States for Federal estate tax purposes.

G.C.M. 22419 is hereby superseded since the positions set forth therein is restated under current law in this Revenue Ruling.

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

Chapter 12—Gift Tax

Subchapter B. Transfers

Section 2511.—Transfers in General

26 CFR 25.2511–1: Transfers in general.

The transfer to a trust of jointly-held independently severable property with reserved joint and survivor life estates is a reciprocal exchange between joint tenants, not a gift, to the extent the transfers are of equal value.

Rev. Rul. 69–505

Advice has been requested as to the treatment, for Federal gift tax purposes, of certain transfers under the circumstances described below.

A and *B* owned certain property as joint tenants. Under applicable state law, the tenancy could be severed by the independent action of either but if not severed the property would pass to the survivor upon the death of one cotenant. They transferred this jointly-held property valued at $20,000.00 to a trust. Under the terms of the trust agreement, the trustee is directed to pay one-half of the income from the transferred property to each of the donors for life and all to the survivor for life. At the death of the survivor, all payments of income shall cease and the trustee is directed to distribute the trust principal to a named individual, *C*. As of the date of the transfer, *A* was aged 50 and *B* was aged 47.

For the purpose of the Federal gift tax, the value of the gift is the value of

the property transferred less the value of the donor's retained rights in the property. Section 25.2511–1(e) of the Gift Tax Regulations.

The factor which represents the present worth at the time of the gift of the life estate retained by *A* is $0.51970. The present worth at the time of the gift of the life estate retained by *B* is $0.55436. The present worth of the right to receive the income from $1.00 for such time as *A* survives *B* is $0.08265. The present worth of the right to receive the income from $1.00 for such time as *B* survives *A* is $0.11731. The present worth of $1.00 due at the death of the last to die of *A* or *B* is $0.36299. The above factors are based upon U.S. Life Table 38 and interest at 3½ percent.

Where each of two cotenants acting alone may sever jointly-held property, each is considered to have an equal interest in the property. Section 25.2515–2(b)(1) of the regulations. The gratuitous transfer of such property results in a gift by each of one-half the value of the property. Where, as here, the jointly-held property is made the corpus of a trust, with reserved joint and survivor life estates, each donor is considered to have retained for his life the right to receive the income from his interest. A method of computing the retained rights of the donors and the amount of gifts may be illustrated as follows:

Donor A:	
One-half value of property	$10,000.00
Less retained rights $10,000.00 x factor $0.51970	5,197.00
	4,803.00
Property transferred:	
(a) to *B*—$10,000.00 x factor $0.11731	1,173.10
(b) to *C*—$10,000.00 x factor $0.36299	3,629.90
	4,803.00
Donor B:	
One-half value of property	10,000.00
Less retained rights $10,000.00 x factor $0.55436	5,543.60
	4,456.40
Property transferred:	
(a) to *A*—$10,000.00 x factor $0.08265	826.50
(b) to *C*—$10,000.00 x factor $0.36299	3,629.90
	4,456.40

Recapitulation

	Donor A	Donor B
Transfer to *C*	$3,629.90	$3,629.90
Net transfer to other joint tenant	346.60	0.00
Total gifts made by parties	3,976.50	3,629.90

The transfers between the joint tenants are treated as a reciprocal exchange for consideration in money or money's worth. See *United States* v. *Estate of Joseph P. Grace,* 395 U.S. 316 (1969) Ct. D. 1927, page 173, this Bulletin. Thus, neither is considered to have made a gift to the other to the extent that the transfers are of equal value. Here, *A* transferred to *B* an interest in property valued at $1,173.10 and *B* transferred to *A* an interest valued at $826.50. Since the gift by *B* is less than the gift by *A*, *A* is deemed to have made a gift to *B* of the difference in the amount of $346.60.

Subtitle C—Employment Taxes

Chapter 21—Federal Insurance Contributions Act

Subchapter B. Tax on Employers

Section 3111.—Rate of Tax

26 CFR 31.3111–3: When employer tax attaches.

Vacation and bonus pay. See Rev. Rul. 69–587, page 108.

Subchapter C. General Provisions

Section 3121.—Definitions

26 CFR 31.3121(a)–1: Wages. (Also Sections 3306, 3401; 31.3306(b)–1, 31.3401(a)–1.)

Amounts charged against so-called contract coal miners accounts that represent charges or expenditures for supplies or services for personal use are wages; however, amounts for items used in mining operations are not; S.S.T. 138 and S.S.T. 326 superseded.

Rev. Rul. 69–451 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the positions set forth in S.S.T. 138, C.B. 1937–1, 442, and S.S.T. 326, C.B. 1938–2, 325.

The question presented concerns the proper method of computing the "wages" of certain contract coal miners, for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24, respectively, subtitle C, Internal Reve-

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

nue Code of 1954). The specific question presented is whether certain amounts should be treated as "wages," for the purposes stated.

Many of the company's coal mining employees are so-called contract miners employed on a contract basis at specified rates per car of coal mined or per linear yard of excavation. On a contract miner's due bill covering a half-month period, his account is credited at the specified rate with the number of cars of coal mined or yards excavated. From this amount the company deducts the cost of the labor of the miner's helpers paid by it, the Federal Insurance Contributions Act employee tax and income tax required to be withheld, dues, fees, assessments, rents, and certain items of supplies and equipment, safety clothing, and facilities that are furnished to the contract miners by the company. The balance of the amount is paid to the contract miner by the company. The items of supplies, equipment, and facilities are described as follows:

(1) *Explosives, fuses, cartridge paper, and detonating caps.*—These items are used for the purpose of dislodging the coal that has been undercut either by hand or machine.

(2) *Lamps.*—Underground miners are required by the nature of their occupation to work by artificial light. Electric cap lamps and batteries used in the work are owned by the company. In some instances the employee purchases a special belt designed to support the batteries and it becomes the property of the employee. It is stated that the safety lighting equipment is of no value to the employee unless he is working in the mine.

(3) *Tools.*—The tools used by an employee are usually his property. When the employee leaves a particular job, he may sell the tools or take them with him.

(4) *Miner's checks.*—These checks are placed by an employee upon the mine cars when loaded underground and are removed at the tipple. They serve as evidence of the amount of coal loaded by the employee. Each employee purchases a number of these checks at the time of his employment.

(5) *Self-rescuers.*—These devices are in the nature of gas masks to be used where the air is contaminated. They are the property of the miner but are of no value for use outside the mine.

(6) *Safety clothing.*—This term includes safety shoes, safety caps or helmets, goggles, knee pads, and elbow pads. The articles are purchased outright by the employee and may be retained by him when he leaves his employment. However, the employee buys these articles solely for use in his daily occupation and has no use for them after the termination of that occupation.

(7) *Hospital and medical fees.*—The mining company maintains a hospital, as required by State law. The company makes a fixed monthly charge against the account of each employee whether or not he uses the facility.

With exceptions not material here, sections 3121(a) and 3306(b) of the above-mentioned Acts, respectively, define the term "wages" as all remuneration for employment. Section 3401(a) of the Code relating to the withholding of income tax contains a similar definition of "wages."

Section 31.3121(a)-1(e) of the Employment Tax Regulations relating to the Federal Insurance Contributions Act provides, in part, as follows:

Generally the medium in which the remuneration is paid is also immaterial. It may be paid in cash or in something other than cash, as for example, goods, lodging, food, or clothing.

Similar provisions are found in the regulations relating to the Federal Unemployment Tax Act and the Collection of Income Tax at Source on Wages.

It is held that under the facts in the instant case the amounts representing taxes withheld, charges or expenditures for supplies or services for the miner's personal use (such as dues, fees, fuel, and safety clothing), assessments, and rent paid on behalf of the miner are wages of the miner for purposes of the above-mentioned Acts and the withholding of income tax. In addition, amounts deducted to pay for medical and hospital expenses must be included in his wages for those purposes inasmuch as those facilities are for his personal use. However, the amounts paid by the company for helpers and the cost of supplies and materials furnished by it for the use of the contract miner in mining operations, which amounts are charged against the contract miner's account, are not remuneration to him and are not "wages" for purposes of the Federal employment taxes.

S.S.T. 138 and S.S.T. 326 are superseded, since the positions set forth therein are restated under current law in this Revenue Ruling.

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26 CFR 31.3121(a)-1: Wages. (Also Sections 3306, 3401; 31.3306(b)-1, 31.3401(a)-1.)

Commissions paid by a company to its employees for submitting names of prospective customers to whom merchandise was sold are "wages," but such commissions paid to a former customer are not; S.S.T. 207 superseded.

Rev. Rul. 69-452 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in S.S.T. 207, C.B. 1937-2, 452.

The questions presented are whether commissions paid by a company under the circumstances described below are "wages" for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24, respectively, subtitle C, Internal Revenue Code of 1954).

A commission was paid by the company to *A*, an office employee of the company, and to *B*, a former customer of the company. In each case the commission was paid for submitting the name of a prospective customer to

[1] Prepared pursuant to Rev. Proc. 67-6, C.B. 1967-1, 576.

whom merchandise was sold by one of the company's regular salesmen. The usual duties of *A* do not involve any sales activities. No control is exercised over the activities of *B* and he is not an employee of the company.

With exceptions not material here, sections 3121(a) and 3306(b) of the F.I.C.A. and the F.U.T.A., (respectively, define the term "wages" as all remuneration for employment, and sections 3121(b) and 3306(c) of the Acts, respectively, define "employment" as any service, of whatever nature, performed by an employee for the person employing him.

Section 3401(a) of the Code, relating to income tax withholding, defines "wages" as all remuneration for services performed by an employee for his employer, with exceptions not material here.

Section 31.3121(a)–1(c) of the Employment Tax Regulations relating to the F.I.C.A. provides, in part, as follows:

The name by which the remuneration for employment is designated is immaterial. Thus, salaries, fees, bonuses, and commissions on sales or on insurance premiums, are wages if paid as compensation for employment. Similar provisions are found in the regulations relating to the F.U.T.A. and income tax withholding.

In order for remuneration to be "wages" for F.I.C.A. and F.U.T.A. purposes it must be *remuneration for services in employment,* performed by an employee *for the person employing him.* In order for remuneration to be "wages" for income tax withholding purposes it must be for services performed by an employee *for his employer,* with an exception not material here.

Since *A* is an employee of the company, the commission paid to him by the company for submitting the name of a prospective customer to whom merchandise was later sold is "wages" for purposes of the F.I.C.A., the F.U.T.A., and the Collection of Income Tax at Source on Wages.

Since *B* is not an employee of the company, the commission paid to him is not remuneration for services performed by an employee and, therefore, is not "wages" for Federal employment tax purposes.

S.S.T. 207 is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

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26 CFR 31.3121(a)–1: Wages.

Amounts paid to or on behalf of a baseball player pursuant to a "College Scholarship Plan". See Rev. Rul. 69–424, page 15.

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26 CFR 31.3121(a)–1: Wages.

Amounts received by an individual from a university for performing research. See Rev. Rul. 69–425, page 16.

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26 CFR 31.3121(a)–1: Wages.

Vacation and bonus pay. See Rev. Rul. 69–587, page 108.

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26 CFR 31.3121(a)–2. Wages; when paid and received.

Vacation and bonus pay. See Rev. Rul. 69–587, page 108.

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26 CFR 31.3121(b)(7)–1: Services in employ of States or their political subdivisions or instrumentalities.
(Also Sections 3306, 3402; 31.3306(c)(7)–1, 31.3402(a)–1.)

A Connecticut soil and water conservation district formed as a private nonstock corporation by individuals who have complete control over its operations is not a wholly owned instrumentality or political subdivision of the State for Federal employment tax purposes.

Rev. Rul. 69–453

Advice has been requested whether a soil and water conservation district in the State of Connecticut is a wholly owned instrumentality of the State or a political subdivision thereof, for purposes of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act (chapters 21 and 23, respectively, subtitle C, Internal Revenue Code of 1954).

The district was originally an unincorporated association of landowners. Later it was incorporated under the Nonstock Corporation Act of the State of Connecticut. The district's certificate of incorporation shows that its purposes are to make surveys and investigations and do research concerning the problems of soil erosion and its control; to cooperate with or enter into agreements with landowners to develop conservation practices upon their lands; and to assist community conservation commissions and provide soil maps for planning and zoning boards. The certificate of incorporation provides that the board of supervisors, which is elected by the landowners, will develop, with the help of the landowners and operators and assistance from the Soil Conservation Service of the United States Department of Agriculture (1) a district program outlining long-term soil and water conservation objectives and (2) an annual plan as a general guide for carrying on work within the district to attain such objectives.

A memorandum of understanding established a basis for cooperation and assistance among the district, the Connecticut Commissioner of Agriculture and Natural Resources, and the United States Department of Agriculture in their common objective of soil and water conservation.

The State Commissioner agrees (1) to assist the supervisors and the Department in carrying forward the principles of the memorandum; (2) to encourage the supervisors to discover and put into action local resources in an effort to solve soil and water conservation problems; (3) to currently develop and furnish the supervisors suggestions concerning the nature of their duties and the effectiveness of their methods for carrying on their work; (4) to assist the supervisors in every practicable manner through resources available to him and to endeavor to obtain for them assistance from local, State, and Federal agencies; and (5) to provide the supervisors with summaries and analyses of annual reports of other

boards and to initiate liaison work between the various boards of supervisors in the interest of a maximum quantity of effective work throughout the State.

The district agrees (1) that it will upon request or upon its own initiative make recommendations to departmental agencies carrying on conservation work within the district with respect to the development and administration of conservation activities and the overall conservation problems and work plans of the district to best effectuate the purpose of these activities; (2) that it will prepare, with the approval of the State Commissioner, an annual work plan to serve as a guide in carrying out its program during the year ahead; and (3) that, with the approval of the State Commissioner, it will be responsible for determining the kind, amount, and priority of work to be performed by it on farms and other land, and for seeing that the provisions of cooperative agreements it enters into with owners and operators of land are carried out.

The district's operations are managed by the board of supervisors. The supervisors do not take an oath of office and are not bonded. They attend monthly meetings, for which the State pays them at a fixed rate but no State official or body has the authority to remove the supervisors from office.

The participating landowners present to the supervisors proposals for conservation work on their property. The proposals are reviewed and, if they are accepted, contracts are entered into between the landowners and the district. The contracts require the district to provide the necessary equipment and the equipment operator and set forth the hourly rates for the use of the equipment and the hire of the operator. The supervisors need not obtain permission from the Connecticut Commissioner of Agriculture and Natural Resources to enter into the contracts and no Federal or State official can exercise a veto over their activities. The contract is not signed by the State Commissioner and the district is bound to carry out its obligations thereunder. The State Commissioner cannot order or direct the supervisors to do anything that they do not approve or do not consider to be in the best interests of the district, the only sanction being to deny the district the use of State equipment, in which event the district would use its own equipment to complete the conservation work.

The district purchases its own supplies and carries its own general liability insurance and workmen's compensation insurance. Its revenue comes from billing landowners for the work it does on their properties. These funds are deposited in a commercial bank checking account or savings account maintained in the district's name, under the complete control of the supervisors. The treasurer of the district handles all funds and pays all expenses, including the salary of the equipment operator. An annual financial and operational report for the past year and for contemplated projects is made, which is furnished to the United States Department of Agriculture and the State of Connecticut. The State audits the annual financial report only if requested to do so by the supervisors. In the event the district's operations are terminated, the State would have no claim to its assets other than as a general creditor. The assets would be distributed according to the statute providing for dissolution of a nonstock corporation in Connecticut.

Section 3121(b)(7) of the Federal Insurance Contributions Act excepts from "employment" service performed in the employ of a State, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing which is wholly owned thereby, with exceptions not here material. Section 3306(c)(7) of the Federal Unemployment Tax Act contains a similar provision.

In resolving the question whether an organization is an instrumentality of a state or political subdivision thereof, the following factors are taken into consideration: (1) whether it is used for a governmental purpose and performs a governmental function; (2) whether performance of its function is on behalf of one or more states or political subdivisions; (3) whether there are any private interests involved or whether the states or political subdivisions involved have the powers and interests of an owner; (4) whether control and supervision of the organization is vested in public authority or authorities; (5) whether express or implied statutory or other authority is necessary or exists for the creation and use of the organization; and (6) the degree of financial autonomy and the source of its operating funds. Rev. Rul. 57–128, C.B. 1957–1, 311.

The district is a private nonstock corporation that acts on behalf of private individuals in keeping with the purposes stated in its certificate of incorporation. Any benefit conferred upon the public is merely incidental to this primary purpose. The corporation was formed by private individuals who have complete control over the corporate operations, the control over revenue and expenditures being especially evident.

The State law that concerns the district is regulatory in nature. The State Commissioner has authority to assist private individuals in forming conservation districts but he does not have the power to operate them. The State Commissioner has issued regulations suggesting certain modes of procedure and requiring an annual report on the district's operations and financial status. Also, he has made himself an ex officio member, without vote, of the district's board of supervisors. These regulations however are designed to insure the integrity of the corporation but not to direct its operation. The district, like any other corporation that has an effect on the public interest, is subjected to State regulations designed to protect the public interest.

Accordingly, the soil and water conservation district is not a wholly owned instrumentality of the State of Connecticut or a political subdivision thereof, for purposes of sections 3121(b)(7) and 3306(c)(7) of the Federal

Insurance Contributions Act and the Federal Unemployment Tax Act, respectively. Furthermore, the district is the employer of the supervisors who conduct its affairs and of the equipment operators, for purpose of those Acts and the Collection of Income Tax at Source on Wages (chapter 24, subtitle C, of the Code).

Compare Revenue Ruling 57–120, C.B. 1957–1, 310, and Revenue Ruling 59–373, C.B. 1959–2, 37, which hold that soil conservation districts are political subdivisions of the States therein involved.

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26 CFR 31.3121(d)–1: Who are employees. (Also Sections 3306, 3401; 31.3306(i)–1, 31.3401(c)–1.)

A guardian of an infant beneficiary of a trust who is paid by the trustee under a court order and is accountable only to the court in the discharge of his duties is not an employee of the trust; S.S.T. 181 superseded.

Rev. Rul. 69–435 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in S.S.T. 181, C.B. 1937–2, 387.

The question presented is whether the guardian of an infant beneficiary of a trust is an employee of the trust, for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24, respectively, subtitle C, Internal Revenue Code of 1954).

In accordance with the provisions of the will of *D*, *C* was appointed guardian of the person of *B*, an infant beneficiary of the trust created pursuant to the will. The trustee was directed by a court decree to pay a specific sum annually to *C* for the services he performs as guardian. The trustee has no control over the services performed by *C* in the capacity of guardian. *C* is required to exercise his own discretion in the discharge of his duties and is accountable only to the court that appointed him.

An individual is an employee for Federal employment tax purposes if he has the status of employee under the usual common law rules applicable in determining the employer-employee relationship. Guides for determining that status are found in three substantially similar sections of the Employment Tax Regulations: namely, sections 31.3121(d)–1, 31.3306(i)–1, and 31.3401(c)–1.

Under the facts stated, it is held that the relationship of employer and employee does not exist between the trust and *C* with respect to the services he performs as guardian of *B*. Accordingly, *C* is not an employee of the trust estate for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, or the Collection of Income Tax at Source on Wages.

S.S.T. 181 is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

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26 CFR 31.3121(d)–1: Who are employees. (Also Sections 3306, 3401; 31.3306(i)–1, 31.3401(c)–1.)

Certain waiters engaged by a club to serve private dinners given by club members for their guests are employees of the club, even though the wages paid to the waiters are charged to the members' accounts; S.S.T. 183 superseded.

Rev. Rul. 69–436 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in S.S.T. 183, C.B. 1937–2, 388.

The question presented is whether certain waiters engaged to serve private dinners at a club are employees of the club, for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24, respectively, subtitle C, Internal Revenue Code of 1954).

At various times members of the club use its facilities for entertainment purposes, which necessitates the employment of additional waiters. The club engages the extra waiters, controls and directs them in the performance of their services, pays them their entire remuneration, and bills the club member or members who entertained guests for the amount of the remuneration so paid.

The waiters are employees for Federal employment tax purposes if they have the status of employees under the usual common law rules applicable in determining the employer-employee relationship. Guides for determining that status are found in three substantially similar sections of the Employment Tax Regulations: namely, sections 31.3121(d)–1, 31.3306(i)–1, and 31.3401(c)–1.

Section 31.3121(d)–1 of the regulations provides, in part, that every individual is an employee if under the usual common law rules the relationship between him and the person for whom he performs services is the legal relationship of employer and employee. Generally the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. Other factors characteristic of an employer, but not necessarily present in every case, are the furnishing of the tools and the furnishing of a place to work, to the individual who performs the services.

It is held that the waiters in the instant case are employees of the club

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages. This conclusion is not affected by the fact that the wages paid by the club to the waiters are charged to the members' accounts.

S.S.T. 183 is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

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26 CFR 31.3121(d)–1: Who are employees. (Also Sections 3306, 3401; 31.3306(i)–1, 31.3401(c)–1.)

Trustees in bankruptcy who are in charge of the assets of a company are not its employees for Federal employment tax purposes; S.S.T. 112 superseded.

Rev. Rul. 69–500 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in S.S.T. 112, C.B. 1937–1, 463.

The question presented is whether certain individuals performing services as trustees in bankruptcy are employees of the bankrupt company, for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24, respectively, subtitle C, Internal Revenue Code of 1954).

The trustees in bankruptcy are in charge of the assets of the company. They were selected by the creditors of the company, subject to approval by the court, and are compensated by statutory commissions paid out of the company's assets. None of the trustees has a fixed term of office.

An individual is an employee for Federal employment tax purposes if he has the status of an employee under the usual common law rules applicable in determining the employer-employee relationship. Guides for determining that status are found in three substantially similar sections of the Employment Tax Regulations: namely, sections 31.3121(d)–1, 31.3306(i)–1, and 31.3401(c)–1. As stated in the regulations, generally the relationship of employer and employee exists when the person for whom the services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished.

Under the facts of this case it is held that the company does not exercise, or have the right to exercise, the control prescribed by the regulations as necessary to establish the relationship of employer and employee under the usual common law rules. Accordingly, the trustees are not employees of the company under those rules and the compensation paid to them is not subject to the taxes under the F.I.C.A., or the F.U.T.A., or to Federal income tax withholding.

S.S.T. 112 is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

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26 CFR 31.3121(d)–1: Who are employees. (Also Sections 61, 3306, 3401, 3504; 1.61–1, 31.3306(i)–1, 31.3401(c)–1, 31.3504–1.)

Determination of whether students attending an apprenticeship school established pursuant to an agreement between a union and a contractors association are employees; and whether amounts paid the students are includible in their gross income.

Rev. Rul. 69–519

Advice has been requested whether, under the circumstances stated below, certain pre-apprenticeship and apprenticeship training program students are in an employee status for Federal employment tax purposes, and whether the payments made to them are includible in gross income.

An apprenticeship educational and training trust fund was established pursuant to an agreement between a local union and a contractors association. The purposes of the fund are (1) financing the training and education of pre-apprentices and apprentices, (2) the establishment and maintenance of an apprentice school to furnish and supply facilities, tools, equipment, textbooks, and other materials and supplies for the training of pre-apprentices and apprentices, and (3) such other purposes directly related to the training of apprentices as the fund's board of trustees deems practicable. The fund's activities are financed by all employers party to the agreement paying the fund a fixed amount per hour for each hour worked by all journeymen and apprentices in their employ who are working at a trade and location within the jurisdiction of the union.

The actual training program is administered and operated by a joint apprenticeship committee. The committee is comprised of an equal number of representatives of the employers and of the union and it maintains jurisdiction over the apprentices during their entire apprenticeship period of at least four years.

Individuals who meet certain standards are enrolled in the pre-apprenticeship training program, in which they attend school five days a week (40 hours) for six to eight weeks. In order to induce individuals to enroll in the program, the fund pays the student an hourly rate for attending school, pays the registration fee, and furnishes all materials and supplies. The student is not charged a tuition fee. After completion of the pre-training period the student is assigned by the committee to work for a local contractor and he then becomes an employee of the contractor.

When an individual files an apprenticeship application with the committee he agrees, among other things, that if accepted he will pursue the prescribed course of study related to the trade. Under the apprenticeship agreement, which by reference incorporates the union's apprenticeship standards therein, the committee agrees to be responsible for the placement and training of the apprentices as work is

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

available; the apprentice agrees to diligently and faithfully perform the work incidental to the trade during his period of apprenticeship, in accordance with the regulations of the committee.

The apprenticeship standards prescribe the terms and conditions of an individual's employment during his apprenticeship, including working hours and wage scales. Under these standards the apprentice is to be taught the use, care, and effective and safe handling of all tools and equipment commonly used in the trade and (coordinated with actual work performed on the job) he is to be instructed in accident prevention and safe working habits. He is to be given the work experience and training necessary to assure him the proficiency and skill that characterizes a fully qualified and competent craftsman. The contractor-employer to whom an apprentice is assigned is to designate a particular person to be responsible for his training, work experience on the job, attendance at related classes, and the maintenance of necessary records relating thereto.

Under the apprenticeship standards each apprentice is required to enroll in and attend classes in subjects related to the trade for a specified number of hours a year. The failure of an apprentice to fulfill his obligations for school attendance, studies, or deportment is ground for disciplinary action, including suspension or revocation of his apprenticeship. In practice, an apprentice is required to attend the apprenticeship school one day a week during the regular school season over a period of two years. For the time spent in school the fund pays him at the same hourly rate that he is paid by his contractor-employer.

The students 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, and 24, respectively, subtitle C, Internal Revenue Code of 1954) if they have the status of employees under the usual common law rules applicable in determining the employer-employee relationship. Guides for determining that status are found in three substantially similar sections of the Employment Tax Regulations: namely, sections 31.3121(d)–1, 31.3306(i)–1, and 31.3401(c)–1.

It is held that under the circumstances stated the pre-apprenticeship students are not employees, and the payments made to them are not remuneration for employment. These individuals have not been employed by the fund or by any contractor. If they do not complete their pre-apprenticeship training, they may never become apprenticed to a contractor. Accordingly, liability for the taxes under the Federal Insurance Contributions Act and the Federal Unemployment Tax Act and for the Collection of Income Tax at Source on Wages is not incurred with respect to the payments.

As regards the apprentices who are assigned to contractors, the employment relationship between the contractor-employer and the apprentice is not disturbed by the apprentice's absence from the job to attend school. The payments made are definitely a part of the wage structure and are based on an hourly rate for the time spent in school. The employer is a contributor to the fund from which the payments are made. Accordingly, the amounts paid to the apprentices from the apprenticeship educational and training trust fund are wages for purposes of the Federal Insurance Contributions Act and the withholding of income tax. Liability for the taxes under the Federal Insurance Contributions Act is incurred by the contractor-employers at the time the payments are made to the apprentices and not when the employers make their contributions to the fund. Such liability is incurred only to the extent the payments attributable to an employer when made to an apprentice during the calendar year do not, when added to the regular wages paid to him from the beginning of the year by the same employer, exceed the statutory limitation of $7,800 provided in section 3121(a) of that Act.

For purposes of income tax withholding, the fund is the "employer" of the apprentices under section 3401(d) of the Code. That section provides, in part:

> (1) if the person for whom the individual performs or performed the services does not have control of the payment of the wages for such services, the term "employer" * * * means the person having control of the payment of such wages; * * *.

Accordingly, as the "employer" of the apprentices for income tax withholding purposes, the fund is required to withhold and pay over Federal income tax on the payments made to each apprentice.

The above conclusions applicable to the Federal Insurance Contributions Act are also applicable for purposes of the Federal Unemployment Tax Act.

Except as otherwise provided by the Code, gross income under section 61 of the Code means all income from whatever source derived. There are no specific provisions in the Code for the exclusion of the amounts paid to the pre-apprenticeship training program students or the apprenticeship training program students. Accordingly, these payments are includible in the gross incomes of the recipients.

Revenue Procedure 68–21, C.B. 1968–1, 817, discusses the treatment of vacation trust funds, under circumstances similar to those in this case, pursuant to section 31.3504–1 of the regulations. (See section 3 of the Revenue Procedure.) Section 31.3504–1 of the regulations provides, in part, that in the event wages of an employee or group of employees, employed by one or more employers, are paid by a fiduciary, agent, or other person, or if such fiduciary, agent, or other person has the control, receipt, custody, or disposal of such wages, the District Director of Internal Revenue may, subject to such terms and conditions as he deems proper, authorize such fiduciary, agent, or other person to perform such acts as are required of the employer or employers in respect of such wages for

purposes of the taxes imposed by the Federal Insurance Contributions Act.

The circumstances relating to the payments by the fund in the instant case are substantially similar to those relating to the payment of the vacation allowances from vacation trust funds referred to in Revenue Procedure 68–21. The vacation funds are administered by joint trustees composed of an equal number of representatives of the union and of the employers and the vacation allowances are paid by the funds under rules established by the trustees. In the instant case the fund pays the apprentice for the time he spends in school, pursuant to the agreement between the contractors and the local union.

The payments made to the apprentices by the fund under the circumstances described are sufficiently similar to the vacation allowances in Revenue Procedure 68–21 to come within the purview of the Revenue Procedure. Accordingly, pursuant to section 31.3504–1 of the regulations the fund may apply to the District Director of Internal Revenue for authorization to perform such acts as are required of the employer or employees with respect to the payments to the apprentices from the fund for purposes of the Federal Insurance Contributions Act.

If authorization is granted to the fund by the District Director pursuant to section 31.3504–1 of the regulations, the fund may also report the payments made to the apprentices for purposes of the Federal Unemployment Tax Act on its Form 940 for each calendar year in which the payments are made. (See section 4 of Revenue Procedure 68–21.)

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26 CFR 31.3121(d)–1: Who are employees. (Also Sections 3306, 3401; 31.3306(i)–1, 31.3401(c)–1.)

Certain waiters, chefs, and other individuals engaged by a catering company to perform services in connection with the serving of food and refreshments prepared by the company are employees of the company; Em.T. 438 superseded.

Rev. Rul. 69–624 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in Em.T. 438, C.B. 1943, 1063.

The question presented is whether certain waiters, chefs, and other individuals performing services in connection with the catering business of a restaurant company are its 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, and 24, respectively, subtitle C, Internal Revenue Code of 1954).

The restaurant company operates a catering service in addition to its restaurant. Its catering customers include individuals, corporations, social clubs, churches, universities, and others. A customer requesting catering service is asked what type of food and refreshments is desired, the number of guests to be served, the number and type of workers necessary to conduct the service efficiently, whether any particular worker is desired, and what equipment (such as tables, linens, chairs, silverware, dishes) is required for the occasion. The company renders an estimate of the charge for the complete service, based on the information provided by the customer, and it later submits a bill itemizing the charges made for the food, rental of equipment, compensation of the workers, and other incidentals.

The company maintains a list of workers who are available for its catering jobs. The workers are engaged by the company for particular jobs, are required to report at specified times, and their compensation is based upon an established scale for the type of work performed. The full amount of the charge to the customer for their services is paid to the workers. The workers are well-trained and experienced and usually furnish their own uniforms and such equipment as carving sets.

It is the usual practice for the company to furnish the headwaiter designated for the occasion with a master sheet or schedule outlining the procedure to be followed in serving the food and setting forth each item of equipment furnished by the company. Supervision over the services of the individuals is generally divided between the company, or one of the waiters engaged, and the customer for whom the affair is conducted. The company requires the workers to appear on the job at the time arranged, to see that the food is served properly, to take adequate precautions to safeguard the company's equipment, and to observe proper rules of personal conduct.

The individuals are employees for Federal employment tax purposes if they have the status of employees under the usual common law rules applicable in determining the employer-employee relationship. Guides for determining that status are found in three substantially similar sections of the Employment Tax Regulations: namely, sections 31.3121(d)–1(c), 31.3306(i)–1, and 31.3401(c)–1.

Section 31.3121(d)–1(c) of the regulations provides, in part, that generally the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so.

The facts in the instant case show that the individuals are engaged to perform personal services in the business of the company and that, in the per-

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

formance of the services, they are subject to the right of the company to exercise such direction and control as is necessary to establish an employment relationship between the company and the individuals. Accordingly, it is held that the waiters, chefs, and other individuals performing services for the company in connection with the serving of food and refreshments prepared for its customers are employees of the company for purposes of chapters 21, 23, and 24 of the Code.

Em.T. 438 is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

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26 CFR 31.3121(d)–1: Who are employees. (Also Sections 3306, 3401; 31.3306(i)–1, 31.3401(c)–1.)

Cattle buyers performing services for a livestock company, a clearing agency, who operate as individual traders and are registered as independent dealers are not employees of the company; Em.T. 448 superseded.

Rev. Rul. 69–625 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in Em.T. 448, C.B. 1944, 545.

The question presented is whether, under the circumstances described below, cattle buyers performing services for a livestock company are its 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, and 24, respectively, subtitle C, Internal Revenue Code of 1954).

The cattle buyers perform services in connection with the purchasing, selling, and handling of cattle. The livestock company is operating a clearing agency and is not engaged in the buying, selling, or trading of cattle or livestock. It finances the operations of the cattle buyers, furnishes bonds to guarantee their purchases, provides bookkeeping services and office space, and makes collections. The cattle buyers are required to deliver to the company all moneys received by them from the sale of cattle and the company, after deducting certain charges, delivers the net profits to the buyers. The cattle buyers are not restricted by the company as to the number or quality of cattle purchased or as to the manner in which they perform their services. They operate as individual traders in livestock and are registered as independent dealers with the United States Department of Agriculture, as provided for in the Packers and Stockyards Act of 1921, as amended (7 U.S.C. 181).

An individual is an employee for Federal employment tax purposes if he has the status of employee under the usual common law rules applicable in determining the employer-employee relationship. Guides for determining that status are found in three substantially similar sections of the Employment Tax Regulations: namely, sections 31.3121(d)–1, 31.3306(i)–1, and 31.3401(c)–1. Generally, the relationship of employer and employee exists when the person for whom the services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished.

Under the facts in this case, the livestock company does not exercise, or have the right to exercise, the control prescribed by the regulations as necessary to establish the relationship of employer and employee under the usual common law rules. Accordingly, it is held that the cattle buyers are not employees of the livestock company for purposes of chapters 21, 23, or 24 of the Code.

Em.T. 448 is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

26 CFR 31.3121(d)–1: Who are employees.
(Also Sections 3306, 3401; 31.3306(i)–1, 31.3401(c)–1.)

An executor of an estate who is engaged by the other executors to perform services for the estate outside the scope of his official duties is an employee of the estate with respect to the special services; Em.T. 444 superseded.

Rev. Rul. 69–656 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in Em.T. 444, C.B. 1943, 1070.

The question presented is whether one of the executors of an estate who performs certain services for it is an employee of the estate, for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24, respectively, subtitle C, Internal Revenue Code of 1954).

The executor was engaged by the other executors to perform services for the estate outside the scope of his official duties as executor. He is subject to supervision and the control of the other executors in the performance of these services and receives remuneration from the estate in addition to his remuneration for services as executor. The decedent's will specifically recognizes that any executor may perform certain incidental services for the estate outside the scope of his official duties.

The executor is an employee for Federal employment tax purposes with regard to the incidental services if he has the status of employee under the usual common law rules applicable in determining the employer-employee relationship. Guides for determining that status are found in three substantially similar sections of the Employment Tax Regulations: namely, sections 31.3121(d)–1(c), 31.3306(i)–1, and 31.3401(c)–1.

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[1] Prepared pursuant to Rev. Proc. 67–6 C.B. 1967–1, 576.

Section 31.3121(d)–1(c) of the regulations provides, in part, that generally the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so.

Revenue Ruling 69–657, this page holds a fiduciary managing an estate (under the circumstances stated in that ruling) is not an employee of the estate, for Federal employment tax purposes.

As a general rule, a fiduciary is not considered an employee of an estate as to either his official duties or as to any services performed for the estate outside the scope of his official duties. The essentials of employment are lacking in the case of a sole executor or administrator. Where, however, as in the instant case, two or more fiduciaries engage one of their number to perform services for the estate that are specifically recognized as being outside the scope of the fiduciary's official duties, it is considered that, as to such special services, the fiduciary may be an employee provided the requisite control exists.

Since the executor in the instant case is subject to the supervision and the control of the other executors in the performance of his special services, it is held that with respect to those services he is an employee of the estate, for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages.

Em.T. 444 is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

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26 CFR 31.3121(d)–1: Who are employees. (Also Sections 3306, 3401, 6011; 31.3306(i)–1, 31.3401(c)–1, 31.6011(a)–1, 31.6011(a)–3, 31.6011(a)–4.)

A fiduciary (receiver) of a bank, appointed by and acting under the authority of a court, is not an employee of the bank; the trust or estate managed by the fiduciary is generally the employer; S.S.T. 120 superseded.

Rev. Rul. 69–657 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in S.S.T. 120, C.B. 1937–1, 375.

The questions presented are whether, under the circumstances described below, the fiduciary (receiver) of a bank is an employee of the bank and whether a trust or estate managed by the fiduciary is an employer, for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24, respectively, subtitle C, Internal Revenue Code of 1954).

A petition for the appointment of a receiver for the bank was filed by the Commissioner of Banking of the State. The receiver was appointed and is acting under the authority and direction of the Circuit Court for the county in which the bank is located.

An individual is an employee for Federal employment tax purposes if he has the status of employee under the usual common law rules applicable in determining the employer-employee relationship. Guides for determining the status are found in three substantially similar sections of the Employment Tax Regulations: namely, sections 31.3121(d)–1, 31.3306(i)–1, and 31.3401(c)–1. Generally the relationship of employer and employee exists when the person for whom the services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished.

Under the facts in this case, it is held that the bank does not exercise, or have the right to exercise, the control prescribed by the regulations as necessary to establish the relationship of employer and employee under the usual common law rules. Accordingly, the fiduciary is not an employee of the bank for purposes of Chapter 21, 23, or 24 of the Code. The same conclusion would be reached if the fiduciary were a trustee in bankruptcy, administrator of an estate, or liquidator of a bank. See Revenue Ruling 69–500, page 185, this Bulletin. Which holds that trustees in bankruptcy are not employees of a company, under the usual common law rules.

A trust or estate managed and conducted by the fiduciary is generally the employer for Federal employment tax purposes of all employees managed and controlled by him. This construction of the statutes is applicable not only to express trusts but also to corporations and estates whose affairs are being administered or liquidated by trustees in bankruptcy and State and Federal receivers, including bank liquidators. Returns reporting the Federal employment taxes in the name of the trust or estate are to be filed by the fiduciary.

S.S.T. 120 is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

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26 CFR 31.3121(d)–1: Who are employees.

Whether a consultant is an employee. See Rev. Rul. 69–647, page 100.

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26 CFR 31.3121(d)–2: Who are employers. (Also Sections 3306, 3401; 31.3306(a)–1, 31.3401(d)–1.)

A trust created under a decedent's will is an employing entity distinct from the estate of the

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

decedent and is the employer of individuals employed in the management and operation of the trust estate; S.S.T. 343 superseded.

Rev. Rul. 69–658 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in S.S.T. 343, C.B. 1938–2, 306.

The question presented concerns the status, for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24, respectively, subtitle C, Internal Revenue Code of 1954) of a trust created under a will.

The trust was created under the will of a decedent and a trustee was appointed to manage and operate the trust property for the benefit of the beneficiary. Five individuals were employed by the trustee to assist him in the management and operation of the trust estate. The specific question is whether the trust is an employing entity separate and distinct from the estate of the decedent, for purposes of the above-mentioned chapters.

Section 31.3121(d)–2 of the Employment Tax Regulations provides, in part, that an employer may be an individual, a corporation, a partnership, a trust, an estate, a joint-stock company, an association, or a syndicate, group, pool, joint venture, or other unincorporated organization, group, or entity. A trust or estate, rather than the fiduciary acting for or on behalf of the trust or estate, is generally the employer.

Whether the trust is an inter vivos or testamentary trust, the trustee is considered to be engaged in the management and operation of the trust as a separate entity. In such a case the trust estate is, therefore, an employing entity distinct from the trustor, or his estate if deceased, and any individuals employed in connection with the management or operation of the trust estate are employees of the trust estate. See Revenue Ruling 69–657, page 189, this Bulletin.

Therefore, it is held that the trust created under the decedent's will is an employing entity and is the employer of the individuals engaged by the trustee, for purposes of chapters 21, 23, and 24 of the Code.

S.S.T. 343 is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

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26 CFR 36.3121(1)(1)–1: Agreements entered into by domestic corporations with respect to foreign subsidiaries.

Amended regulations relating to filing with service centers the agreements Form 2032 for extending insurance coverage under Title II of the Social Security Act to employees of foreign subsidiaries. See T.D. 7012, page 244.

Chapter 22—Railroad Retirement Tax Act

Subchapter D. General Provisions

Section 3231.—Definitions

26 CFR 31.3231(b)–1: Who are employees. (Also Section 1402; 1.1402(c)–1.)

Physicians serving as local surgeons for a railway company that pays them retainer fees, but neither exercises nor has the right to exercise control over their activities, are not employees of the company for railroad retirement tax purposes; C.T. 18 superseded.

Rev. Rul. 69–390 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in C.T. 18, C.B. 1939–2, 295.

The question presented is whether certain physicians are employees of a railway company for purposes of the Railroad Retirement Tax Act (chapter 22, subtitle C, Internal Revenue Code of 1954).

The railway company by oral agreement engaged the services of certain physicians, designated local surgeons, to assist the chief surgeon of the company in the treatment of its sick and injured employees and other persons injured on the company's right of way. The local surgeons perform their services within assigned territories subject to general suggestions from the chief surgeon. Although the chief surgeon may advise a certain course of treatment for patients, the local surgeons are in every instance solely responsible for the result of their treatment. They are required to make a report to the chief surgeon after the first examination of each patient and another report when the treatment is concluded. They are paid monthly retainer fees but receive no other remuneration for their services.

The local surgeons maintain offices at their own expense, furnish their own equipment, and are not required to keep regular office hours with respect to the services rendered for the company or to devote a minimum amount of time thereto. Their services are performed at their own offices, in hospitals, or wherever the patients may be. They are otherwise engaged in general practice and devote a relatively small portion of their time to work for the company. The company agrees to give reasonable notice of dismissal to any local surgeon whose services are to be discontinued.

Section 3231 of the Railroad Retirement Tax Act provides, in part, as follows:

(b) * * * the term "employee" means any individual in the service of one or more employers for compensation; * * *.

Section 31.3231(b)–1 of the Employment Tax Regulations provides in part, that an individual is in the service of an employer, with respect to services rendered for compensations, if he is subject to the continuing authority of the employer to supervise and direct the manner in which he renders such services. It is not necessary that the employer actually direct or control the manner in which the services are ren-

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

dered; it is sufficient if the employer has the right to do so. The right of an employer to discharge an individual is also an important factor indicating that the individual is subject to the continuing authority of the employer to supervise and direct the manner of rendition of the services. Other factors indicating that an individual is subject to the continuing authority of the employer to supervise and direct the manner of rendition of the services are the furnishing of tools and the furnishing of a place to work by the employer to the individual who renders the services. In general, if an individual is subject to the control or direction of an employer merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is an independent contractor. An individual performing services as an independent contractor is not, as to such services, in the service of an employer within the meaning of the condition stated in the first sentence of this paragraph.

Whether or not an individual is an employee will be determined upon an examination of the particular facts of the case.

Under the facts presented, the company neither exercises, nor has the right to exercise, the degree of control over the activities of the local surgeons that would make them employees under the provisions of the law and regulations stated above. Accordingly, the local surgeons are not employees of the company for purposes of the Railroad Retirement Tax Act.

In the instant case each local surgeon is carrying on a "trade or business" within the meaning of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A of the Code) and the income he derives therefrom should be considered in computing net earnings from self-employment for purposes of that Act.

Compare Revenue Ruling 69–98, C.B. 1969–1, 268, which contains similar holdings with respect to an attorney serving as counsel for a railway company.

C.T. 18 is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

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26 CFR 31.3231(e)–1: Compensation.

The value of housing accommodations furnished by a railroad company to a section foreman as part of his total remuneration pursuant to an employment agreement is taxable compensation for purposes of the Railroad Retirement Tax Act; C.T. 17 superseded.

Rev. Rul. 69–391 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in C.T. 17, C.B. 1939–2, 318.

The question presented is whether the value of housing accommodations furnished section foremen under the circumstances set forth below is "compensation" within the meaning of section 3231(e)(1) of the Railroad Retirement Tax Act (chapter 22, subtitle C, Internal Revenue Code of 1954).

It had been the practice of a railroad company to furnish, wherever practicable, housing accommodations for section foremen because it was desirable to have this class of employees always available and because, in many cases, the railroad passed through sections of the country where other suitable housing could not be found. The desire of the railroad company to furnish these accommodations to all section foremen was not completely realized and the foremen who were not furnished housing accommodations sought an allowance in lieu of the accommodations. As a result of negotiations, an agreement was entered into which specifies the amount of remuneration to be paid to all section foremen. Those who are not furnished housing accommodations are paid $20x$ dollars in cash each month, and those who are furnished such accommodations are paid $18x$ dollars in cash each month, it being agreed that the value of the housing accommodations is $2x$ dollars a month.

Section 3231(e) of the Railroad Retirement Tax Act provides, in part, as follows:

(1) The term "compensation" means any form of money remuneration earned by an individual for services rendered as an employee to one or more employers, or as an employee representative, including remuneration paid for time lost as an employee, but remuneration paid for time lost shall be deemed earned in the month in which such time is lost. Such term does not include tips (except as is provided under paragraph (3)), or the voluntary payment by an employer, without deduction from the remuneration of the employee, of the tax imposed on such employee by section 3201. * * *

If an employer and employee have agreed that housing accommodations of an appropriate fixed value are a part of the employee's total remuneration, the value of the accommodations is "compensation" for the purpose of the Railroad Retirement Tax Act. On the other hand, if the employment agreement does not provide, either expressly or impliedly, for the inclusion of a fixed value for housing accommodations as part of the employee's remuneration, such value is not "compensation" for the purpose of the Railroad Retirement Tax Act. A determination of whether, in any case, the value of housing accommodations is taxable compensation for purposes of the Act must be based upon the particular facts of that case.

In the instant case the result of the agreement entered into was to establish a certain *money remuneration* for all foremen. In other words, the effect of the agreement was that all foremen would receive the same amount of remuneration, some foremen receiving all of it in cash and others in cash and housing accommodations. The fixed value of the housing accommodations so furnished is, in effect, subtracted from the total amount of the foremen's agreed remuneration in determining

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

the amount of cash compensation to be paid to him. Under the circumstances in this case, it is held that the *fixed* value of the housing accommodations (that is, the difference between the cash payment of remuneration to those not furnished housing accommodations and the cash payment to those furnished such accommodations) is taxable "compensation" for the purpose of the Railroad Retirement Tax Act.

C.T. 17 is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

Chapter 23—Federal Unemployment Tax Act

Section 3301.—Rate of Tax

26 CFR 31.3301–1: Persons liable for tax.

Vacation and bonus pay. See Rev. Rul. 69–587, page 108.

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26 CFR 31.3301–2: Measure of tax.

Vacation and bonus pay. See Rev. Rul. 69–587, page 108.

Section 3306.—Definitions

26 CFR 31.3306(a)–1: Who are employers.

Whether a trust is a new employing entity, separate and distinct from the estate of the decedent. See Rev. Rul. 69–658, page 189.

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26 CFR 31.3306(b)–1: Wages.

Amounts paid to or on behalf of a baseball player pursuant to a "College Scholarship Plan". See Rev. Rul. 69–424, page 15.

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26 CFR 31.3306(b)–1: Wages.

Amounts received by an individual from a university for performing research. See Rev. Rul. 69–425, page 16.

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26 CFR 31.3306(b)–1: Wages.

Computation of "wages" of contract coal miners. See Rev. Rul. 69–451, page 180.

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26 CFR 31.3306(b)–1: Wages.

Commissions paid to an employee and to a former customer of a company for submitting the names of prospective customers to whom the company sold merchandise. See Rev. Rul. 69–452, page 181.

26 CFR 31.3306(c)(5)–1: Family employment.

Services performed by a father for the estate of his deceased son are not excepted from "employment" for FUTA tax purposes; Em.T. 436 superseded.

Rev. Rul. 69–659 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in Em.T. 436, C.B. 1942–2, 209.

The question presented is whether certain services performed under the circumstances described below are excepted from "employment," as defined in the Federal Unemployment Tax Act (chapter 23, subtitle C, Internal Revenue Code of 1954).

A father performed services for his son in connection with a business operated by the son. The son died and the administrator of his estate continued to operate the business. The father continued performing the same services for the estate that he had performed for his deceased son. The specific question is whether the services performed by the father after his son's death are excepted from "employment" within the meaning of section 3306(c) of the Act.

Section 3306(c) of the Act provides, in part, that for purposes of chapter 23 the term "employment" means any service, of whatever nature, performed by an employee for the person employing him, with certain exceptions, one of which is "Service performed by an individual in the employ of his son, daughter, or spouse, * * *."

Generally, any services that are performed by employees after the employer's death are in the employ of the employer's estate, which is a new employing unit. See Revenue Ruling 69–657, page 189, this Bulletin. Applying this principle to the facts in the instant case, the services performed by the father after the death of his son are not "in the employ of his son" within the meaning of section 3306(c)(5) of the Act. Such services, rather, are performed in the employ of his son's estate, a different employing unit, and the "family employment" exception contained in the Act does not apply. Accordingly, it is held that liability for the tax imposed by the Federal Unemployment Tax Act is incurred with respect to the wages paid to the father for services he performed for the estate, provided the estate is an "employer" as defined in the Act.

Em.T. 436 is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

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26 CFR 31.3306(c)(7)–1: Services in employ of States or their political subdivisions or instrumentalities.

Services performed for a Connecticut soil and water conservation district. See Rev. Rul. 69–453, page 182.

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26 CFR 31.3306(i)–1: Who are employees.

Status of an individual performing services as a guardian. See Rev. Rul. 69–435, page 184.

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26 CFR 31.3306(i)–1: Who are employees.

Waiters engaged and paid by a club to serve private dinners given at the club by its members. See Rev. Rul. 69–436, page 184.

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26 CFR 31.3306(i)–1: Who are employees.

Services performed by trustees in bankruptcy. See Rev. Rul. 69–500, page 185.

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26 CFR 31.3306(i)–1: Who are employees.

Pre-apprenticeship and apprenticeship training program students attending a school established pursuant to an agreement between a union and a contractors association. See Rev. Rul. 69–519, page 185.

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26 CFR 31.3306(i)–1: Who are employees.

Waiters, chefs, and other individuals performing services for a catering company. See Rev. Rul. 69–624, page 187.

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26 CFR 31.3306(i)–1: Who are employees.

Services performed by cattle buyers. See Rev. Rul. 69–625, page 188.

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26 CFR 31.3306(i)–1: Who are employees.

Whether a consultant is an employee. See Rev. Rul. 69–647, page 100.

26 CFR 31.3306(i)–1: Who are employees.

Fiduciary performing special services for an estate. See Rev. Rul. 69–656, page 188.

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26 CFR 31.3306(i)–1: Who are employees.

Services performed by a fiduciary of a bank. See Rev. Rul. 69–657, page 189.

Chapter 24—Collection of Income Tax at Source on Wages

Section 3401.—Definitions

26 CFR 31.3401(a)–1: Wages.

Amounts received by an individual from a university for performing research. See Rev. Rul. 69–425, page 16.

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26 CFR 31.3401(a)–1: Wages.

Computation of "wages" of contract coal miners. See Rev. Rul. 69–451, page 180.

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26 CFR 31.3401(a)–1: Wages.

Commissions paid to an employee and to a former customer of a company for submitting the names of prospective customers to whom the company sold merchandise. See Rev. Rul. 69–452, page 181.

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26 CFR 31.3401(c)–1: Employee.

Status of an individual performing services as a guardian. See Rev. Rul. 69–435, page 184.

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26 CFR 31.3401(c)–1: Employee.

Waiters engaged and paid by a club to serve private dinners given at the club by its members. See Rev. Rul. 69–436, page 184.

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26 CFR 31.3401(c)–1: Employee.

Services performed by trustees in bankruptcy. See Rev. Rul. 69–500, page 185.

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26 CFR 31.3401(c)–1: Employee.

Pre-apprenticeship and apprenticeship training program students attending a school established pursuant to an agreement between a union and a contractor association. See Rev. Rul. 69–519, page 185.

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26 CFR 31.3401(c)–1: Employee.

Waiters, chefs, and other individuals performing services for a catering company. See Rev. Rul. 69–624, page 187.

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26 CFR 31.3401(c)–1: Employee.

Services performed by cattle buyers. See Rev. Rul. 69–625, page 188.

26 CFR 31.3401(c)–1: Employee.

Whether amounts paid by an employer to a retired employee in consideration for part-time consulting and advisory services come within the definition of the term "wages." See Rev. Rul. 69–647, page 100.

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26 CFR 31.3401(c)–1: Employee.

Fiduciary performing special services for an estate. See Rev. Rul. 69–656, page 188.

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26 CFR 31.3401(c)–1: Employee.

Services performed by a fiduciary of a bank. See Rev. Rul. 69–657, page 189.

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26 CFR 31.3401(d)–1: Employer.

Whether a trust is a new employing entity, separate and distinct from the estate of the decedent. See Rev. Rul. 69–658, page 189.

Section 3402.—Income Tax Collected at Source

26 CFR 31.3402(a)–1: Requirement of withholding.

Whether employers are required to withhold income tax on amounts paid to employees as reimbursements for meals on business trips away from home that do not require the employee to stop for sleep or rest.

Rev. Rul. 69–592

Advice has been requested whether an employer must withhold Federal income tax on amounts paid to his employee as reimbursements for meals on business trips away from home that do not require the employee to stop for sleep or rest. The cost of such meals is not deductible for Federal income tax purposes. See *United States* v. *Homer O. Correll, et ux.*, 389 U.S. 299 (1967), Ct. D. 1917, C.B. 1968–1, 64.

In general, amounts received as per diem allowances are not taxable income to the employee unless during the taxable year he has not expended for deductible travel expenses including meals and lodging while away from home on business an amount at least as much as the total amount of the per diem allowances received.

Accordingly, unless it is reasonable to believe, under all the facts and circumstances known to the employer at the time of the reimbursement, that the total per diem allowances paid to an employee during the taxable year will exceed the total of his deductible travel expenses incurred while he is traveling away from home on business, no withholding of income tax is required with respect to per diem allowances paid to cover his meal expenses on trips that do not require him to stop for sleep or rest.

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26 CFR 31.3402(a)–1: Requirement of withholding.

Amounts paid to or on behalf of a baseball player pursuant to a "College Scholarship Plan". See Rev. Rul. 69–424, page 15.

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26 CFR 31.3402(a)–1: Requirement of withholding.

Amounts received by an individual from a university for performing research. See Rev. Rul. 69–425, page 16.

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26 CFR 31.3402(a)–1: Requirement of withholding.

Payment for services performed by employees of a Connecticut soil and water conservation district. See Rev. Rul. 69–453, page 182.

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26 CFR 31.3402(f)(6)–1: Withholding exemptions for nonresident alien individuals.

A nonresident alien employee, not a resident of Canada, Mexico, or Puerto Rico, is entitled to only one withholding exemption for purposes of computing the amount of income tax to be withheld notwithstanding the provisions of section 3402(m)(3)(E) of the Code.

Rev. Rul. 69–454

A nonresident alien individual (not a resident of Canada, Mexico, or Puerto Rico), is an employee of a corporation in the United States and his wages are subject to income tax withholding under section 3402 of the Internal Revenue Code of 1954.

Held, the nonresident alien individual is entitled to only one withholding exemption for purposes of computing the amount of income tax to be withheld from his wages under section 3402 of the Code, since under section 3402

(m)(3)(E) of the Code, any withholding allowances to which the employee might otherwise be entitled under section 3402(m) of the Code are to be treated as withholding exemptions that are subject to the limitations of section 3402(f)(6) of the Code.

Chapter 25—General Provisions Relating to Employment Taxes

Section 3504.—Acts to be Performed by Agents

26 CFR 31.3504–1: Acts to be performed by agents.

Payments made by an apprenticeship educational and training trust fund to pre-apprenticeship and apprenticeship training program students. See Rev. Rul. 69–519, page 185.

Subtitle D—Miscellaneous Excise Taxes

Chapter 31—Retailers Excise Taxes

Subchapter E. Special Fuels

Section 4041.—Imposition of Tax

26 CFR 48.4041–9: Exemption for use as supplies for vessels or aircraft.

Whether special motor fuels are exempt under section 4041(e) of the Code when sold for use as supplies for civil aircraft employed in foreign trade and registered in Finland. See Rev. Rul. 69–404, page 213.

Subchapter F. Special Provisions Applicable to Retailers Tax

Section 4055.—State and Local Government Exemption

Whether an independent, nonprofit visiting nurse association comes within the scope of the exemption relating to States and local governments. See Rev. Rul. 69–438, page 213.

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. (Also 48.4061(b)–2.)

Taxability of various types of refrigeration units, designed to be installed in truck or trailer bodies, in the light of the decisions in *U.S. Thermo Control Co.* and *Thermo King Corporation;* Revenue Ruling 63–23 modified in part.

Rev. Rul. 69–392

Advice has been requested as to the status, for purposes of the manufacturers excise tax imposed by section 4061 of the Internal Revenue Code of 1954, of the various types of refrigeration equipment described below, in the light of the decision in the case of *U.S. Thermo Control Co.* v. *United States* and *Thermo King Corporation* v. *United States,* 372 F. 2d 964 (1967), certiorari denied 389 U.S. 839 (1967).

Type 1. This unit is self-contained and is designed for use in refrigerating truck or truck trailer bodies subject to the tax imposed on automotive bodies by section 4061(a) of the Code. Each unit consists of a compressor, condenser, and an evaporator. The evaporator is of the conventional fin and tube type. When installed in a truck or trailer body, the self-contained unit is usually mounted in a housing attached to the outside of the front or rear wall of the body. In the case of a split unit the evaporator is mounted outside of either the front or rear wall and the compressor-condenser unit is mounted under the floor of the body. The split unit and self-contained unit are typical of those that were involved in the *U.S. Thermo Control Co.* case.

Type 2. This unit consists of a compressor and a condenser similar to those contained in the *Type 1* unit. However, instead of a fin and tube type evaporator, the system employs "holdover plates" that are connected to the compressor and condenser and mounted or hung within the truck or trailer body. The compressor and condenser may be mounted in a housing attached to the outside of the body, or in the skirting, or it may be attached to the chassis. The electrical power to activate this unit is frequently derived from a source outside the vehicle. However, some models are so equipped that the power source is within or mounted on the vehicle.

Type 3. Although it is designed to perform the same function as the *Type 1* and *Type 2* units (*i.e.,* to provide refrigeration for a truck or truck trailer body), this unit operates on a different refrigeration principle. No compressor, condenser, or evaporator is employed. The system consists of a container, tubing, and a thermostatic control. The refrigerating element is liquid nitrogen which is stored in the container. Upon a signal from the thermostat, the liquid nitrogen is released from the container through a perforated overhead tube. The liquid nitrogen instantly turns to vapor, absorbing heat in the process and producing the controlled temperature desired.

Type 4. This type is a holdover cabinet designed to be installed in a truck or truck trailer body. It is usually found in a local-delivery truck body and is used to preserve ice cream and milk as well as frozen food during the delivery period. In some models compressors and condensers are parts of the holdover cabinets. In other models the compressors and condensers are mounted in the vehicle separate from the cabinets. Some of the cabinets are designed to be activated from an electrical source removed from the vehicle, while others are so designed that they are activated from a power source within, or mounted on, the body. The cabinets are chilled prior to the start of delivery rounds, and the refrigeration is "held over" during the delivery period.

Section 4061(a)(1) of the Code imposes a tax upon various motor vehicle articles, including truck and truck trailer bodies, sold by the manufacturer, producer, or importer thereof (including in each case parts or accessories sold on or in connection therewith or with the sale thereof).

Section 4061(b)(1) of the Code imposes a tax upon parts or accessories for articles enumerated in section 4061(a)(1), sold by the manufacturer, producer, or importer thereof.

Section 48.4061(b)–2(a) of the Manufacturers and Retailers Excise Tax Regulations provides that the term "parts or accessories" includes (1) any article the primary use of which is

to improve, repair, replace, or serve as a component part of an automobile truck or bus chassis or body, or taxable tractor, (2) any article designed to be attached to or used in connection with such chassis, body, or tractor to add to its utility or ornamentation, and (3) any article the primary use of which is in connection with such chassis, body, or tractor, whether or not essential to its operation or use.

In the *U.S. Thermo Control Co.* case, the United States Court of Claims concluded that certain mechanical refrigeration units designed to be installed in taxable truck or truck trailer bodies are not subject to the tax imposed by section 4061(b)(1) of the Code when sold by the manufacturer, producer, or importer of the units.

Revenue Ruling 68–136, C.B. 1968–1, 453, holds that refrigeration units of the type involved in the *U.S. Thermo Control Co.* case are not subject to the tax imposed on parts or accessories by section 4061(b)(1) of the Code. The Revenue Ruling also holds that in computing the tax imposed by section 4061(a)(1) of the Code upon the sale of truck and trailer bodies, the portion of the sale price attributable to refrigeration units sold on or in connection with the sale of such bodies is to be excluded from the tax base.

The questions presented in this Revenue Ruling relate specifically to (a) the type of refrigeration units that are considered to come within the ambit of the decision in the *U.S. Thermo Control Co.* case, and (b) assuming a truck or trailer body is refrigerated by a nontaxable unit, the part of the selling price of the body that may be considered attributable to the sale price of the nontaxable refrigeration unit.

A manufacturers excise tax was first imposed on mechanical refrigerators and refrigeration equipment by section 546 of the Revenue Act of 1941. The following year that tax was limited to refrigerators and refrigeration equipment of the "household type" by section 614 of the Revenue Act of 1942. Essential to the decision in *U.S. Therno Control Co.* was the court's conclusion that the units there involved were of a type that would have been taxable under the Revenue Act of 1941, but would have been excluded from tax by the Revenue Act of 1942 by reason of the fact that the units were of a commercial rather than a "household type." It was further concluded by the court that the removal of the tax from commercial refrigeration equipment by the Revenue Act of 1942 was evidence of Congressional intent to remove such equipment from all manufacturers excise taxation, including the tax on automotive articles currently imposed by section 4061 of the Code.

The Internal Revenue Service has concluded that the *Type 1* units described above are physically like those in *U.S. Thermo Control Co.* Although the *Types 2, 3, and 4* units described above are physically different in some respects they are considered comparable to those in the court case in that they are mechanical refrigeration units of a kind that would have been subject to the manufacturers excise tax imposed by section 546 of the Revenue Act of 1941. Furthermore, because these units are of a commercial rather than a household type they would also have been excluded from that tax when section 614 of the 1942 Act was adopted. Since the *Types 1, 2, 3, and 4* units are comparable to the units in *U.S. Thermo Control Co.,* they are considered to come within the ambit of the decision in that case, and, accordingly, it is held that they are not articles subject to the manufacturers excise taxes imposed by sections 4061(a) and 4061(b) of the Code.

In determining the taxable sale price of an automotive body containing a *Type 1, 2, 3, or 4* unit there should be excluded from the total sale price of the body an amount representing the sale price of the refrigeration unit. The sale price of the refrigeration unit includes that portion of the total sale price of the automotive body that represents a charge for installing the unit and for any additional parts added to complete the installation.

If a body manufacturer sells, for a single price, a taxable truck or truck trailer body with a nontaxable refrigeration unit installed therein, the tax base for the body is to be determined by allocating the total selling price of the body in the manner described below.

If the manufacturer makes separate sales in substantial quantities at established prices of both the taxable body (without the refrigeration unit) and the nontaxable refrigeration unit *installed* (that is, the manufacturer sells units *installed* to customers who own bodies), the tax base should be determined by applying to the manufacturer's sale price of the combination, the ratio that the manufacturer's separate sale price of the taxable body (without the refrigeration unit) bears to the sum of the separate sale prices of the taxable body (without the refrigeration unit) and the nontaxable refrigeration unit *installed.*

Where the articles are not sold separately by the manufacturer, or where they are sold separately but not in substantial quantities at established prices, the tax base should be determined by applying to the total sale price of the body (including the refrigeration unit), the ratio that the manufacturer's cost of the body without the refrigeration unit bears to the total cost of the body including the *installed* refrigeration unit.

In view of the conclusion that the *Type 2* unit described above is not a taxable automotive part or accessory, it follows that holdover plates, and hangers therefor, designed for use with *Type 2* units are not taxable automotive parts or accessories. Accordingly, Revenue Ruling 63–23, C.B. 1963–1, 206, is hereby modified to the extent that it concludes that holdover plates, and hangers therefor, designed for use in truck or truck trailer bodies are taxable automotive parts or accessories.

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26 CFR 48.4061(a)–1: Imposition of tax.

Modification of a truck chassis to fit a beverage truck body constitutes

further manufacture of the chassis; the vendee-owner retaining a proprietary interest in the chassis is liable for the manufacturers tax upon his use of the modified chassis.

Rev. Rul. 69–418

Advice has been requested whether the modification of a new automobile truck chassis in the manner described below constitutes an act of manufacture so that liability for the manufacturers excise tax, imposed by section 4061(a)(1) of the Internal Revenue Code of 1954, is incurred upon the sale or use of the modified chassis.

In accordance with a practice common in his business, a beverage distributor purchased from a body manufacturer a "drop frame" pallet type automobile truck body suitable for making deliveries of his products. However, the body manufacturer did not sell truck chassis.

The beverage distributor purchased from a chassis manufacturer a standard "deck" type truck chassis that required modification to accommodate the "drop frame" body. The chassis manufacturer reported and paid the manufacturers excise tax imposed on the sale of the truck chassis by section 4061(a)(1) of the Code. The chassis was delivered to the body manufacturer, who made the modifications described below in the chassis and installed the body on the modified chassis. The beverage distributor retained title to the truck chassis during the period of modification.

The truck chassis purchased by the beverage distributor had a frame structure made of reinforced channel steel. The height of the chassis was 26 inches from the ground, providing adequate road clearance for "deck" type truck bodies. However, to accommodate the "drop frame" body the chassis was dropped to a height of 12 inches, resulting in a lower center of gravity.

To accommodate the body it was necessary for the body manufacturer to modify the chasis by decreasing the distance from the rear of the cab to the rear axle. This required a change in the length of the drive shaft. The body manufacturer also cut the frame structure under the cab and in front of and behind the wheel housing. He dropped the frame structure, shortened the rear springs, relocated and installed heavy duty bumpers, relocated the battery box, and performed other similar work.

Section 4061(a)(1) of the Code imposes a tax upon the sale by the manufacturer, producer, or importer of certain motor vehicle articles, including bodies and chassis for automobile trucks.

Under the provisions of section 4218(a) of the Code, if any person manufactures, produces, or imports an automobile truck chassis and uses it (otherwise than as material in the manufacture or production of, or as a component part of, another taxable article to be manufactured or produced by him), then he shall be liable for the manufacturers excise tax in the same manner as if such article were sold by him.

Section 4221(a) of the Code provides that no manufacturers excise tax shall be imposed on the sale by the manufacturer of an article for use by the purchaser for further manufacture, but only if such use is to occur before any other use. Under the provisions of section 4221(d)(6) of the Code, an automobile truck chassis shall be treated as sold for use in further manufacture if such article is sold for use by the purchaser as material in the manufacture or production of, or as a component part of, another taxable article to be manufactured or produced by him.

To the extent relevant in this case, section 6416(b)(3) of the Code provides that if the manufacturers excise tax has been paid with respect to the sale of any article by the manufacturer, producer, or importer thereof to a second manufacturer or producer, such tax shall be deemed to be an overpayment by such second manufacturer or producer, for purposes of credit or refund, if such article is used by the second manufacturer or producer as material in the manufacture or production of, or as a component part of another taxable article manufactured or produced by him.

Section 316.4(a) of Regulations 46 made applicable to the 1954 Code by Treasury Decision 6091, C.B. 1954–2, 47, defines the term "manufacturer" to include a person who produces a taxable article from scrap, salvage, or junk material, as well as from new or raw material, (1) by processing, manipulating, or changing the form of an article, or (2) by combining or assembling two or more articles. Section 316.4(b) of the regulations provides that under certain circumstances, as where a person manufactures or produces a taxable article for a person who furnishes materials and retains title thereto, the person for whom the taxable article is manufactured or produced, and not the person who actually manufactures or produces it, will be considered the manufacturer.

The Internal Revenue Service has had many occasions to determine whether the modification of a new taxable article by the manufacturer's vendee was an act of manufacture by such vendee so that liability for the manufacturers excise tax was incurred upon the sale or use of the modified article.

Illustratively, Revenue Ruling 58–32, C.B. 1958–1, 391, holds that lengthening a regular passenger automobile chassis by cutting the chassis and adding necessary parts and materials, so that it will accommodate a funeral coach or ambulance body, is an act of further manufacture of the chassis. Similarly, Revenue Ruling 60–81, C.B. 1960–1, 506, holds that "stretching" complete automobiles into limousines, hearses, ambulances, etc. constitutes an act of further manufacture of both the chassis and the bodies. Revenue Ruling 60–155, C.B. 1960–1 410, holds that the conversion (by shortening) of an automobile truck chassis into a tractor designed for transporting house trailers is further manufacture of the chassis.

Revenue Ruling 63–191, C.B. 1963–2, 478, involves three situations in which automobile truck chassis are purchased for use in the production of street-sweeper vehicles. In two of those situations, the conversion (by shortening) of the chassis by the purchaser constitutes an act of further manufacture. However, in the third situation, the chassis is resold without significant modification by the purchaser (along with a body of that purchaser's manufacture). Consequently, there is no act of further manufacture with respect to the chassis purchased in the third situation.

For manufacturers excise tax purposes, a determination as to whether a new taxable article has been further manufactured by the manufacturer's vendee depends upon whether the article sold or used by that vendee is significantly different from the article purchased from the initial manufacturer. It is not necessary that a truck chassis, for example, be so modified that it is something other than a truck chassis; it is sufficient that it become a different truck chassis.

In this case, it is held that the truck chassis as modified to accommodate the "drop frame" body for use by the beverage distributor is a different article, for purposes of the manufacturers excise tax, from the standard truck chassis purchased by the beverage distributor from the manufacturer thereof. Thus, the modification of the chassis by the body manufacturer constitutes further manufacture of the original chassis.

It is further held that, in view of his retention of the proprietary interest in the chassis, the beverage distributor is the manufacturer of the modified chassis. Therefore, under the provisions of sections 4061(a)(1) and 4218(a) of the Code, the beverage distributor incurred liability for the manufacturers excise tax upon his use of the modified chassis. For a similar conclusion, see *Vinal* v. *Peterson Mortuary, Inc.*, 353 F. 2d 814 (1965), in which the proprietary interest test was applied to hold that Peterson Mortuary, rather than the fabricator, was the manufacturer of a hearse and an ambulance that had been produced by the conversion of standard passenger automobiles.

Since the manufacturers excise tax was paid with respect to the sale, in this case, of the standard truck chassis that was used in further manufacture, the beverage distributor is entitled to a credit or refund of that overpayment under the provisions of section 6416(b)(3) of the Code. However, under the provisions of section 4221(a) of the Code, the standard truck chassis could have been sold free of tax to the beverage distributor for use in further manufacture, subject to the registration requirements of section 4222 of the Code.

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26 CFR 48.4061(a)–1: Imposition of tax.

Where the total of direct labor and material costs of restoring a milk tank body exceeds 25 percent of the full retail sale price of the restored body, the restorer is liable for the manufacturers tax.

Rev. Rul. 69–419

Advice has been requested concerning the Federal manufacturers excise tax consequences, under section 4061 of the Internal Revenue Code of 1954, of selling restored milk tank truck and trailer bodies.

The dairy equipment industry is made up in part of a limited number of manufacturers who engage in the manufacture and sale of bulk milk pickup and transport tanks. This is a highly specialized field and these units must be manufactured to meet rigid standards of state and federal health and sanitation departments. When a milk tank body fails to meet these standards (for example, it becomes damaged in an accident), it may not be used.

Because of the daily demands for service, the owner of a damaged milk tank body frequently must have a replacement immediately. If time and distance were not factors, this owner would instruct the manufacturer to make the necessary repairs to the tank body. However, because of these factors, the manufacturer accepts the damaged body in trade as part of the selling price of a new or restored tank body. The damaged body is restored by the manufacturer to marketable condition and resold by him. Normally the selling price of a restored unit is one-third to one-half of the selling price of a comparable new milk tank body.

The units received in trade that are restored to marketable condition as milk tank bodies usually require some work on the outer jacket; one or more sections or the entire outer jacket may be replaced. The catwalks and skirting usually require some work as well. If the outer jacket, or a portion thereof, is replaced, new insulation between the replaced outer jacket and inner tank is required. In some cases the capacity of the used tank is increased or decreased by adding or discarding sections of both the inner tank and outer jacket.

The milk tank industry has asked the Internal Revenue Service to provide guidelines for determining when the restoration of a used milk tank body becomes "manufacture" of a body for purposes of the manufacturers excise tax imposed by section 4061(a)(1) of the Code.

Section 4061(a)(1) of the Code imposes a tax on the sale by the manufacturer, producer, or importer of certain enumerated articles including automobile truck bodies and truck trailer and semitrailer bodies.

Section 316.4(a) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C.B. 1954–2, 47, provides that the term "manufacturer" includes a person who produces a taxable article from scrap, salvage, or junk material, as well as from new or raw material, (1) by processing, manipulating, or changing the form of an article, or (2) by combining or assembling two or more articles.

The Service has established from an analysis of the material submitted by the automotive milk tank industry an

administrative guide for determining whether the operations involved in restoring trade-in tank bodies constitute "manufacturing." Dollar costs in themselves are not determinative. However, on the basis of the analysis conducted by the Service it has been ascertained that in cases where the total of direct labor and direct material costs of restoring a milk tank body is 25 percent or less of the full retail sale price of the restored body (without regard to any trade-in allowance for another used body), the operation was not sufficiently extensive to constitute "manufacture" of the restored body for purposes of the tax imposed by section 4061(a)(1) of the Code. Accordingly, the sale of such a body by the restorer thereof is not subject to the tax imposed by section 4061(a)(1).

On the other hand, the material submitted discloses that in cases where the total of direct labor and direct material costs of restoring a milk tank body exceeds 25 percent of the full retail sale price of the restored body, the restoration operation is sufficiently extensive so that the body can be presumed to have been "manufactured" by the restorer. In accordance with this presumption of taxability, the tax is applicable with respect to all milk tank bodies coming within the foregoing test, unless the restorer establishes that a particular body was not, in fact, remanufactured. Although such a restorer of milk tank bodies may not be engaged in the manufacture of new milk tank bodies, he is nevertheless a "manufacturer" with respect to taxable restored bodies.

For purposes of this Revenue Ruling, in determining the total of direct material costs the cost or value of the used body is not to be considered an element of such costs.

If a manufacturer's records indicate in any particular case that his costs were not determined in accordance with standard accepted accounting principles or that his selling price departed from his normal price for a particular body, he will be required to establish to the satisfaction of the Service that such variances are for reasons other than manufacturers excise tax avoidance.

Under the provisions of section 4221(a)(1) of the Code and the regulations pertaining thereto, a manufacturer of taxable bodies may purchase taxable parts or accessories on a tax-free basis for use in further manufacture, subject to the registration requirements of section 4222 of the Code. If such parts or accessories are used in the restoration of a tank body the sale of which is not subject to tax under the foregoing guidelines, the restorer is liable for tax on those parts or accessories in accordance with the provisions of section 4223 of the Code. Furthermore, under the provisions of section 4218(c) of the Code, a restorer is liable for tax on any parts or accessories manufactured by him and used in the restoration of a tank body that is not subject to tax.

On the other hand, if a restorer purchases parts or accessories directly from the manufacturer on a tax-paid basis and uses them in the restoration of a tank body the sale of which is subject to tax under the foregoing guidelines, section 6416(b)(3)(B) of the Code permits the restorer to claim a credit or refund of the manufacturers excise tax paid with respect to those parts or accessories by the manufacturer thereof.

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26 CFR 48.4061(a)-1: Imposition of tax.

Vehicles that are used for moving material around supply yards and manufacturing plants and that, because of their design and construction, are not suitable for highway use, are not subject to the tax imposed by section 4061(a)(1) of the Code.

Rev. Rul. 69-541

Advice has been requested regarding the taxability under section 4061(a) of the Internal Revenue Code of 1954 of the vehicles described below.

Vehicle 1: A company manufactures a material handling vehicle consisting of a flatbed steel platform mounted on a two-axle chassis. One side of the platform contains hydraulically operated twin booms and ganders, and a one-man operator's cab. The other side of the platform is used as cargo space. The vehicle is powered by a 145 horsepower diesel engine, and has a heavy-duty power shift transmission similar to those used in earth moving equipment. It has air brakes and is equipped with a hydraulic power steering system that is not in conformity with Interstate Commerce Commission standards for highway vehicles.

The vehicle is 26 feet long, has a 16-foot wheelbase, and, excluding the loading equipment, is 101 inches wide. With the addition of the loading equipment, and when the booms are folded for travel, the width of the vehicle is 125 inches and its height is 149 inches.

The vehicle is equipped with front and rear lights. It is also equipped with hydraulic outriggers to provide additional stability while handling heavy loads. The unit weighs 26,000 pounds, can lift a 10,000-pound load, and has a load capacity of 20,000 pounds. The unit is especially suitable for loading and unloading pipes, poles, and steel billets from freight cars; and for handling materials in and around supply yards and manufacturing plants.

Vehicle 2: This vehicle is similar to the one described above except that its unloaded weight is 45,000 pounds. It can lift a 20,000-pound load and can carry a 40,000-pound load. When the lifting equipment for this vehicle is folded its width is 150 inches.

Section 4061(a)(1) of the Code imposes a tax on certain articles sold by the manufacturer thereof. Among the articles enumerated in that section are truck bodies and chassis. Section 48.4061(a)-1(d) of the Manufacturers and Retailers Excise Tax Regulations provides that a chassis or body specified in Code section 4061(a) which is not designed for highway use is not subject to the tax imposed by such section.

Because of their height, width, axle ratings, and steering system, neither the chassis nor bodies of the vehicles described above are suitable for transportation on the highway. Accordingly, sales of such articles are not subject to the tax imposed by section 4061(a)(1) of the Code.

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26 CFR 48.4061(a)–1: Imposition of tax.

Trailers, ordinarily towed by trucks over the highway to and from job sites, that are designed to carry garden tractors, ditch-diggers, and other similar devices, are taxable under section 4061(a)(1) of the Code.

Rev. Rul. 69–552

The Internal Revenue Service has been asked whether the trailers described below are taxable under section 4061(a)(1) or under section 4061(a)(2) of the Internal Revenue Code of 1954.

A company manufactures various size trailers designed to carry garden tractors, ditch-diggers, and other similar kinds of equipment over the highways from job site to job site. The trailers have load capacities ranging from 1000 to 8000 pounds, two or four wheels, and fixed single or tandem axles. All are equipped with lights and wiring. The units have either fixed or tilt-top beds; self-contained foldaway loading ramps; safety locks and chains and ball, latch, or pintle type hitches. The larger trailers have heavy-duty frames, leaf springs, and electrical or hydraulic four-wheel brakes as standard equipment. Similar brake systems are available, as an option, on the lighter trailers.

Even though some of these trailers are towed by passenger automobiles in some instances, they are ordinarily towed by trucks.

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, including truck trailer and semitrailer chassis and bodies. Section 4061(a)(2) of the Code currently imposes a tax at a lower rate on sales of chassis and bodies for trailers and semitrailers (other than house trailers) suitable for use in connection with passenger automobiles.

Section 48.4061(a)–1(e) of the Manufacturers and Retailers Excise Tax Regulations provides that a trailer or semitrailer chassis or body primarily designed for highway use in combination with a taxable truck or tractor is subject to the tax imposed by section 4061(a)(1) of the Code. That section of the regulations further provides that trailers and semitrailers suitable for use in combination with passenger automobiles, but which are not house trailers, are subject to the tax imposed by section 4061(a)(2) of the Code. A trailer designed for use in combination with a passenger automobile, and which is commonly referred to as a "utility trailer," is an example of a trailer taxable under section 4061(a)(2) of the Code.

A trailer is deemed to be "suitable for use" with passenger automobiles if it has actual, practical, commercial fitness for such use or is commonly used with passenger automobiles.

The trailers in the instant case are not suitable for use with passenger automobiles within the actual, practical, commercial fitness concept. Accordingly, it is held that these trailers are articles subject to the tax imposed by section 4061(a)(1) of the Code, rather than the tax imposed by section 4061(a)(2).

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26 CFR 48.4061(a)–1: Imposition of tax. (Also 48.4061(b)–2.)

Applicability of the manufacturers tax to sales of motor vehicles with air-conditioning units installed therein, and to separate sales of such air-conditioning units.

Rev. Rul. 69–578

Advice has been requested concerning the applicability of the manufacturers excise tax imposed by section 4061(a) of the Internal Revenue Code of 1954 to automobile trucks, automobile buses, tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer, and passenger automobiles when these articles are sold by the manufacturer with air-conditioning units installed therein. Advice has also been requested concerning the applicability of section 4061(b) of the Code to separate sales of such air-conditioning units by the manufacturer thereof.

Section 4061(a)(1) of the Code imposes a tax upon various motor vehicle articles, including automobile trucks, automobile buses, and truck-tractors sold by the manufacturer, producer, or importer thereof (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof). Section 4061(a)(2) of the Code imposes a tax upon other motor vehicle articles, such as passenger automobiles (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof).

Section 4061(b)(1) of the Code imposes a tax upon parts or accessories for any of the articles enumerated in section 4061(a)(1) sold by the manufacturer, producer, or importer thereof. However, section 4061(b)(2) of the Code, effective January 1, 1966, provides that this tax shall not be imposed upon any part or accessory which is suitable for use (and ordinarily is used) on or in connection with, or as a component part of, any article enumerated in section 4061(a)(2) or a house trailer.

Section 48.4061(b)–2(a) of the Manufacturers and Retailers Excise Tax Regulations provides that the term "parts or accessories" includes (1) any article the primary use of which is to improve, repair, replace, or serve as a component part of an automobile, truck or bus chassis or body, or taxable tractor, (2) any article designed to be attached to or used in connection with such chassis, body, or tractor to add to its utility or ornamentation, and (3) any article the primary use of which is in connection with such chassis, body, or tractor, whether or not essential to its operation or use.

Section 48.4061(b)-2(d) of the regulations lists numerous examples of articles taxable as parts or accessories, the first of which is "Automobile air conditioners." Applicability of the tax to the articles included in this illustrative list is subject, of course, to the subsequently enacted provisions of section 4061(b)(2) of the Code.

The tax imposed by section 4061(a) of the Code applies to each of the articles enumerated therein as sold by the manufacturer, producer, or importer, including all of its parts or accessories irrespective of whether those parts or accessories, if sold separately, would be subject to the tax imposed by section 4061(b) of the Code. When motor vehicles (trucks, buses, tractors, or passenger automobiles) are sold by the manufacturer with air-conditioning units installed therein, those units are integral parts of the vehicles for purposes of the manufacturers excise tax.

Therefore, it is held that the manufacturers excise tax imposed by section 4061(a) of the Code applies to the price for which the trucks, buses, highway-type tractors, and passenger automobiles in this case are sold by the manufacturer without any reduction because of the air-conditioning units installed therein.

In accordance with the provisions of section 48.4061(b)-2(a) of the regulations, it is further held that the manufacturers excise tax imposed by section 4061(b)(1) of the Code applies to separate sales of air-conditioning units designed for installation in trucks, buses, or highway tractors. However, under the provisions of section 4061(b)(2) of the Code, the tax on "parts or accessories" does not apply to the separate sale of an air-conditioning unit that is suitable for use (and ordinarily is used) on or in connection with, or as a component part of, a passenger automobile or house trailer.

The applicability of the manufacturers excise tax to separate sales of air-conditioning units that are primarily designed for use in connection with motor vehicles has consistently been determined under section 4061(b) of the Code. Section 48.4111-2(c) of the regulations provides that such units are not included within the meaning of the term "self-contained air-conditioning units" for purposes of the now-repealed tax imposed by section 4111 of the Code.

See also, for example, Revenue Ruling 63-23, C.B. 1963-1, 206, which includes in a listing of articles that have been held taxable as automobile parts or accessories "Air conditioners, equipped with internal combustion engines, designed for installation in bus bodies." An earlier ruling held that air-conditioning units primarily designed or adapted for use on motor vehicles were subject to the tax on automobile "parts or accessories" rather than the tax on self-contained air-conditioning units. Rev. Rul. 56-544, C.B. 1956-2, 797.

The foregoing conclusions are not considered as having been affected by the decision of the United States Court of Claims in the case of *U.S. Thermo Control Co.* v. *United States* and *Thermo King Corporation* v. *United States,* 372 F. 2d 964 (1967), certiorari denied, 389 U.S. 839 (1967), which was based upon a different legislative and administrative history relating to the applicability of the manufacturers excise taxes to certain commercial refrigeration units for installation in truck or trailer bodies. The acceptance of that decision by the Internal Revenue Service, without extension to other articles, has been announced in Revenue Ruling 68-136, C.B. 1968-1, 453, and Revenue Ruling 69-392, page 194, this Bulletin.

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26 CFR 48.4061(a)-1: Imposition of tax. (Also Section 4063.)

Certain automotive bodies equipped with heavy-duty unloading equipment and used primarily for hauling feed, seed, and fertilizer to and on farms, are exempt from manufacturers tax under section 4063(a)(2)(B) of the Code; Revenue Ruling 66-315 revoked.

Rev. Rul. 69-579

The Internal Revenue Service has reconsidered the position set forth in Revenue Ruling 66-315, C.B. 1966-2, 463, with respect to whether certain bulk feed bodies are subject to the manufacturers excise tax imposed on sales of automotive articles by section 4061(a)(1) of the Internal Revenue Code of 1954.

The articles involved are truck, trailer, or semitrailer bodies used primarily for hauling animal and poultry feed to farms and unloading such products into bins and troughs on the farms. The bodies contain heavy-duty mechanical or pneumatic type unloading equipment specially designed to facilitate unloading on the farm. The unloading equipment is built into, and forms an integral part of, the bodies, adding substantially to their cost and weight, and limiting their load-carrying capacity. The mechanical system employs conveyors or augers, and unloads from the top of the body; the pneumatic system employs a blower and hose, and usually unloads from the bottom and rear of the body. Each system is activated by a power take-off from the truck engine. The bodies are usually divided into separate compartments and are either open at the top or completely enclosed. The enclosed type body is equipped with sliding doors on top to permit easy loading at grain elevators.

Section 4061(a)(1) of the Code imposes a tax on the sale by the manufacturer, producer, or importer of certain enumerated articles including automobile truck bodies and truck trailer and semitrailer bodies.

Section 4063(a)(2)(B) of the Code provides that the tax imposed by section 4061 shall not apply in the case of any body, part, or accessory primarily designed to haul feed, seed, or fertilizer to and on farms.

In the case of *Highway Equipment Co.* v. *United States,* the United States District Court for the Northern District of Iowa, entered January 18, 1968, the court held that certain auto

mobile bodies, substantially similar to those described above, were primarily designed to haul feed to and on farms within the meaning of section 4063(a)(2)(B) of the Code, and consequently were exempt from the tax imposed by section 4061(a)(1). A similar conclusion was reached in the case of *B. M. Clark Co., Inc.* v. *United States,* United States District Court, District of Maine, Southern Division, entered July 31, 1969.

Upon reconsideration of Revenue Ruling 66–315, the Service has concluded that the automotive bodies involved are not designed primarily for the general hauling of feed, seed, or fertilizer over the highway. The elaborate and expensive unloading systems built into these bodies, and the modifications of the bodies required to accommodate the unloading systems, make it impractical to purchase the bodies for use other than in hauling feed, seed, or fertilizer to, and unloading it on, farms.

Accordingly, it is held that the described automotive bodies are primarily designed to haul feed, seed, or fertilizer to and on farms, within the meaning of section 4063(a)(2)(B) of the Code, and are therefore exempt from the tax imposed by section 4061(a)(1).

Revenue Ruling 66–315 is hereby revoked.

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26 CFR 48.4061(a)–1: Imposition of tax.

Trailers with permanently installed equipment to service electrical power units at generating substations and trailers designed as mobile television studios are subject to tax under section 4061(a)(1) of the Code; however, no tax applies to the specialized equipment.

Rev. Rul. 69–597

Advice has been requested concerning the taxability under section 4061(a)(1) of the Internal Revenue Code of 1954 of the trailers described below.

Item 1: A company designs and manufactures a trailer to house permanently installed control equipment used to service electrical power generating units at generating substations. The purpose of the trailer is to transport the control equipment over the highway to various generating substations operated by a public utility. Upon arrival at a particular generating station the vehicle is immobilized and the control equipment is connected to electric power generation equipment and to the generating station itself. When the power generation control equipment is no longer needed at a particular generating station, it is disconnected and towed to another station or to a warehouse where it is stored until it is again needed.

Item 2: A company designs and manufactures a customized trailer for use as a mobile television studio. The mobile studio contains a control room, switching unit, video tape machine, and television cameras. The trailer is towed over the highway to various sites to cover news and sporting events, and to videotape television programs and commercials. To increase its stability the trailer is immobilized during broadcasting and recording sessions.

Section 4061(a) of the Code imposes a tax upon the sale by the manufacturer, producer, or importer of various motor vehicle articles, including truck trailers and semitrailers chassis and bodies. A sale of an automobile truck trailer or semitrailer is considered to be a sale of a body and chassis.

Section 48.4061(a)–1(e)(1) of the Manufacturers and Retailers Excise Tax Regulations provides that a trailer or semitrailer chassis or body primarily designed for highway use in combination with a taxable truck, bus, or tractor is subject to the tax imposed by section 4061(a)(1) of the Code. The tax attaches even though the trailer or semitrailer may have equipment to perform functions other than in connection with the transportation of property or persons. However, no tax under section 4061(a) attaches to that part of the selling price of the complete unit which is reasonably attributable to such equipment provided that such part of the selling price is billed separately on the invoice to the customer or can be otherwise established by adequate records.

The two articles in question consist of trailer bodies and chassis fitted with specialized equipment. The trailers are designed and constructed to haul this equipment on the highway. The reason for housing this equipment in such trailers is to provide mobility for the equipment.

By design and use the trailers are highway vehicles as defined by section 48.4061(a)–1(e)(1) of the regulations. Therefore, it is held that sales of these trailers by the manufacturer are subject to the tax imposed by section 4061(a)(1) of the Code. However, no tax applies to the specialized electrical control and television equipment the trailers are designed to transport.

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26 CFR 48.4061(a)–1: Imposition of tax.

Methods to be used in determining the taxable portion of the unit selling price where a taxable article and a nontaxable article are sold together at a single price, for purposes of computing the manufacturers excise taxes imposed under chapter 32 of the Code. See Rev. Rul. 69–394, page 206.

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26 CFR 48.4061(a)–1: Imposition of tax.

Whether automobiles and trucks sold by the manufacturer for export may be driven by the purchaser from the factory to the point of exportation without defeating the tax-free nature of sales for export. See Rev. Rul. 69–395, page 212.

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26 CFR 48.4061(a)–1: Imposition of tax.

Computation of the manufacturers excise tax where a manufacturer sells articles otherwise than at arm's length to a related entity for the same price as it sells to independent dealers. See Rev. Rul. 69–568, page 209.

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26 CFR 48.4061(a)–1: Imposition of tax.

The constructive sale price to be used by a company selling truck chassis at retail only on special order and at prices determined, in part, by the contractual negotiation in each individual case. See Rev. Rul. 69–580, page 209.

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26 CFR 48.4061(a)–1: Imposition of tax.

Whether the manufacturers excise tax applies to the use of a foreign-made automobile imported by a United States resident. See Rev. Rul. 69–598, page 211.

26 CFR 48.4061(a)–1: Imposition of tax.

Computation of the manufacturers excise tax where an individual imports and uses a foreign-made automobile. See Rev. Rul. 69–640, page 211.

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26 CFR 48.4061(a)–4: Parts or accessories sold on or in connection with chassis, bodies, etc.

Whether the value of bus body parts furnished by the customer must be included in the price for which the completed bus body is sold by the manufacturer. See Rev. Rul. 69–437, page 208.

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26 CFR 48.4061(b)–1: Imposition of tax.

Taxability of tire chains and cross-chain repair links for passenger automobiles, trucks, and buses.

Rev. Rul. 69–553

Advice has been requested whether sales by the manufacturer or importer of the tire chains and the cross-chain repair links described below are subject to the manufacturers excise tax imposed on automotive "parts or accessories" by section 4061(b)(1) of the Internal Revenue Code of 1954.

The tire chains are designed for passenger automobiles, trucks, and buses and are manufactured in accordance with specifications established by the National Association of Chain Manufacturers. The chains are also used on truck and bus trailers or semitrailers, house trailers, and highway-type tractors. The tire chains are identified as follows:

Vehicle	Type	Service	Code series
Passenger automobile chains.	P	Highway	1200
	RP	Reinforced	1800
Light truck single chains	LSH	Highway	2200
	LSM	Mud	2400
	RLS	Reinforced	2800
Regular truck single chains	SH	Highway	2200
	SM	Mud	2400
	RS	Reinforced	2800
Light dual truck and bus chains.	LDH	Highway	3200
	LDM	Mud	3400
	LDTH	Highway	4200
	LDTM	Mud	4400
	RLDT	Reinforced	4800
Regular dual truck and bus chains.	DH	Highway	3200
	DM	Mud	3400
	DTH	Highway	4200
	DTM	Mud	4400
	RDT	Reinforced	4800

The cross-chain repair links are curved metal links which, when their ends are looped through two end links in a broken cross-chain and closed, form new links in the repaired chain. The repair links are manufactured in various wire sizes for the repair of cross-chains for tire chains for passenger automobiles, trucks, and buses.

Section 4061(b)(1) of the Code imposes a tax upon parts or accessories (other than tires and inner tubes) for any article enumerated in section 4061(a)(1) sold by the manufacturer, producer, or importer. Enumerated in section 4061(a)(1) of the Code are chassis and bodies for trucks and buses, and for truck and bus trailers and semitrailers. Also enumerated are tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer.

Section 4061(b)(2) of the Code provides that the tax imposed by section 4061(b)(1) shall not be imposed upon any part or accessory which is suitable for use (and ordinarily is used) on or in connection with, or as a component part of, any article enumerated in section 4061(a)(2) or a house trailer. Enumerated in section 4061(a)(2) of the Code are automobile chassis and bodies other than those taxable under section 4061(a)(1), and chassis and bodies for trailers and semitrailers (other than house trailers) suitable for use in connection with passenger automobiles.

The tire chains described above for trucks and buses (Types LSH, LSM, RLS, SH, SM, RS, LDH, LDM, LDTH, LDTM, RLDT, DH, DM, DTH, DTM, and RDT) are for use with articles taxable under section 4061(a)(1) of the Code. They are not suitable for use (and are not ordinarily used) on or in connection with a passenger automobile, a trailer or semitrailer suitable for use with a passenger automobile, or a house trailer. Accordingly, it is held that sales by the manufacturer or importer of such tire chains are subject to the tax on "parts or accessories" imposed by section 4061(b)(1) of the Code.

The tire chains listed above for passenger automobiles (Types P and RP) come within the exception provided by section 4061(b)(2) of the Code. Accordingly, it is further held that sales thereof are not subject to the tax on "parts or accessories" imposed by section 4061(b)(1) of the Code.

Cross-chain repair links designed for repairing tire chains for trucks and buses are subject to the tax imposed by section 4061(b)(1) of the Code when sold by the manufacturer or importer.

Sales of cross-chain repair links designed for repairing tire chains for passenger automobiles are not subject to the manufacturers excise tax.

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26 CFR 48.4061(b)–1: Imposition of tax.

Methods to be used in determining the taxable portion of the unit selling price where a taxable article and a nontaxable article are sold together at a single price, for purposes of computing the manufacturers excise taxes imposed under chapter 32 of the Code. See Rev. Rul. 69–394, page 206.

26 CFR 48.4061(b)–1: Imposition of tax.

Computation of the manufacturers excise tax where a manufacturer sells articles otherwise than at arm's length to a related entity for the same price as it sells to independent dealers. See Rev. Rul. 69–568, page 209.

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26 CFR 48.4061(b)–2: Definition of parts or accessories.

Metal portable chests designed for use in transporting tools or equipment on pickup trucks are subject to the manufacturers tax on parts or accessories.

Rev. Rul. 69–403

Advice has been requested whether the articles described below are subject to the manufacturers excise tax on automotive parts or accessories, imposed by section 4061(b)(1) of the Internal Revenue Code of 1954.

A company manufactures and sells portable tool or equipment chests made of metal. They are advertised principally for use in transporting tools and equipment on pickup trucks. The chests are rectangular in shape with slanted hinged tops, and are available in several basic models that vary in size. The lengths of the models differ so as to correspond to the inside width dimensions of four popular-size pickup truck bodies. Each chest is designed to fit lengthwise across the bed of the appropriate pickup truck body with which it is used.

The top of each chest is constructed with offsets or lips extending lengthwise beyond the sides of the chest so that the chest can rest on the side panels of the pickup truck without touching the truck bed. This feature not only serves to secure the chest on the truck body but allows space beneath the chest for storing other equipment, such as ladders and pipe. The offsets or lips may also be used as handles for carrying the chests. Several chests can be carried on a pickup truck body at the same time. The chests can stand alone and may be used as storage containers in yards, job sites, camping areas, basements, etc., or on the floor of a stake truck or station wagon.

Section 4061(b)(1) of the Code imposes a tax upon parts or accessories (other than tires and inner tubes) for any article enumerated in section 4061(a)(1) when sold by the manufacturer, producer, or importer. Among the articles enumerated in section 4061(a)(1) of the Code are chassis and bodies for trucks.

Section 48.4061(b)–2(a) of the Manufacturers and Retailers Excise Tax Regulations provides that, in general, the term "parts or accessories" includes (1) any article the primary use of which is to improve, repair, replace, or serve as a component part of an automobile truck or bus chassis or body, or taxable tractor, (2) any article designed to be attached to or used in connection with such chassis, body, or tractor, to add to its utility or ornamentation, and (3) any article the primary use of which is in connection with such chassis, body, or tractor, whether or not essential to its operation or use.

The chests described above are designed for use and are primarily used with pickup truck bodies. Therefore, it is held that the chests are automotive "parts or accessories" within the meaning of section 4061(b)(1) of the Code, and sales of the chests by the manufacturer are subject to the tax imposed by that section.

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26 CFR 48.4061(b)–2: Definition of parts or accessories.

Rotary brooms and snowplow blades designed for mounting on trucks are not subject to the tax on automotive parts or accessories, but lifting mechanisms permanently mounted on trucks and used with either the broom or snowplow blade are subject to tax.

Rev. Rul. 69–506

Advice has been requested concerning the application of the manufacturers excise tax imposed by section 4061(b)(1) of the Internal Revenue Code of 1954 to sales by the manufacturer of the articles described below.

A company manufactures rotary brooms and snowplows designed to be mounted on trucks. The company also manufactures lifting mechanisms, consisting of mounting brackets, lifting frames, and hydraulic motors that are sold and used with either the broom or the snowplow blade. Neither the brooms nor the snowplows are designed to perform a loading function.

Section 4061(b)(1) of the Code imposes a tax upon parts or accessories (other than tires or inner tubes) for any of the articles enumerated in section 4061(a)(1) when sold by the manufacturer, producer, or importer. Section 4061(a)(1) of the Code enumerates chassis and bodies for automobile trucks, automobile buses, truck and bus trailers and semitrailers, and highway tractors.

Section 48.4061(b)–2(a) of the Manufacturers and Retailers Tax Regulations defines the term "parts or accessories" as including any article designed to be attached to or used in connection with a chassis or body for a truck, bus, or highway tractor to add to its utility. However, this section of the regulations also provides that an article is not considered to be a taxable part or accessory if the article is in effect the load being transported and the primary function of the article is to serve a purpose unrelated to the vehicle, even though the article is designed to be attached to the vehicle or primarily used with the vehicle.

Rotary brooms and snowplow blades do not add to the utility of a vehicle in transporting persons or property over the highway. Rather, they employ the vehicle as a means of mobility and as a source of power. Therefore, it is held that they are not automotive parts or accessories, and separate sales of rotary brooms and snowplow blades by the manufacturer are not subject to the manufacturers excise tax imposed by section 4061(b)(1) of the Code. However, the lifting mechanism that is permanently mounted on the vehicle is designed to be used in connection with taxable motor vehicles to add to their utility. Therefore, such mechanisms

are considered to be "parts or accessories" and separate sales thereof are taxable under section 4061(b)(1) of the Code. See Revenue Ruling 63–261, C.B. 1963–2, 501, which holds that a "snap coupling hitch" designed to be attached to the front of automobile trucks for the purpose of coupling snowplows to the trucks is a taxable automotive part or accessory.

If, for a single sale price, the manufacturer sells a lifting mechanism with a snowplow blade or a rotary broom, such transaction is a combination sale of a taxable article and a nontaxable article, regardless of whether the articles are sold in an assembled or unassembled condition. The sale of the lifting mechanism under these conditions is subject to the tax imposed by section 4061(b)(1) of the Code on the basis of the portion of the total selling price that is properly attributable to the sale of the lifting mechanism.

If a rotary broom or snowplow assembly of the type described is sold on or in connection with the sale of a vehicle subject to the tax imposed by section 4061(a)(1) of the Code by the manufacturer or importer of the vehicle, the portion of the sale price attributable to the rotary broom or snowplow blade is not subject to the tax imposed by section 4061(a)(1) on the sale of the vehicle. However, the portion of the sale price attributable to the lifting mechanism is subject to such tax as a part or accessory sold on or in connection with the sale of the vehicle.

For the rule to be followed in apportioning a combination sale price between its taxable and nontaxable elements, see Revenue Ruling 69–394, page 206, this Bulletin.

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26 CFR 48.4061(b)–2: Definition of parts or accessories.

Kits designed to secure camper coaches or "slide-in cabins" to pick-up trucks are automotive parts or accessories taxable under section 4061(b)(1) of the Code.

Rev. Rul. 69–542

Advice has been requested whether the article described below is subject to the manufacturers excise tax on automotive parts or accessories imposed by section 4061(b)(1) of the Internal Revenue Code of 1954.

A company manufactures a kit that it advertises and sells for use with a pickup truck on which a camper coach or "slide-in cabin" is mounted. The kit consist of four turnbuckle shock absorbing assemblies and eight metal plates. Each assembly has a hook at both ends. One hook attaches to a metal plate bolted to the camper coach or "slide-in cabin" and the other hook attaches to a metal plate bolted to the truck body. The camper unit is thereby hooked securely to both the front and rear of each side of the truck body. The shock absorbing action stabilizes the unit during transit and also prevents the mountings from tearing loose.

Section 4061(b)(1) of the Code imposes a tax upon parts or accessories (other than tires and inner tubes) for any of the articles enumerated in section 4061(a)(1) when sold by the manufacturer, producer, or importer. Among the articles enumerated in section 4061(a)(1) of the Code are chassis and bodies for trucks.

Section 48.4061(b)–2(a) of the Manufacturers and Retailers Excise Tax Regulations provides that, in general, the term "parts or accessories" includes (1) any article the primary use of which is to improve, repair, replace, or serve as a component part of an automobile truck or bus chassis or body, or taxable tractor, (2) any article designed to be attached to or used in connection with such chassis, body, or tractor, to add to its utility or ornamentation, and (3) any article the primary use of which is in connection with such chassis, body, or tractor, whether or not essential to its operation or use.

The kit described above is designed to be attached to and used in connection with a pickup truck body to add to its utility in transporting a camper coach or "slide-in cabin." Therefore, it is held that the kit is an automotive part or accessory within the meaning of section 4061(b)(1) of the Code, and sales thereof by the manufacturer are subject to the tax imposed by that section.

See Revenue Ruling 63–34, C.B. 1963–1, 210, which holds similarly that boat tie-down straps designed for use in connection with taxable boat trailers to tie or secure boats to such trailers are automobile "parts or accessories" within the meaning of section 4061(b)(1) of the Code.

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26 CFR 48.4061(b)–2: Definition of parts or accessories.
(Also Section 7805; 301.7805–1.)

The tax imposed by section 4061(b)(1) of the Code is applicable to the separate sales of accessorial equipment designed for use or primarily used with taxable tank bodies; effective January 1, 1970.

Rev. Rul. 69–567

Advice has been requested as to the applicability of the manufacturers excise tax on automotive "parts or accessories," imposed by section 4061(b)(1) of the Internal Revenue Code of 1954, to separate sales of accessorial equipment of the type described in Revenue Ruling 69–143, C.B. 1969–1,280.

Revenue Ruling 69–143 lists examples of accessorial equipment used with certain automobile truck, trailer, and semitrailer tank bodies to serve some purpose related either to the operation of the bodies in receiving, preserving, transporting, and dispensing the products carried, or to the maintenance, safety, or preservation of the bodies. That Revenue Ruling holds that where a taxable tank body is sold by the manufacturer thereof fitted with such accessorial equipment, or where a "bare" tank body is sold in combination with such accessorial equipment, the equipment constitutes "parts or accessories therefor sold on or in connection therewith or with the sale thereof" within the meaning of section 4061(a)

(1) of the Code. Consequently, the total sale price of the body and equipment is subject to the manufacturers excise tax imposed by that section.

Section 4061(b)(1) of the Code imposes a tax upon parts or accessories (other than tires and inner tubes) for any article enumerated in section 4061(a)(1) when sold by the manufacturer, producer, or importer.

Section 48.4061(b)-2(a) of the Manufacturers and Retailers Excise Tax Regulations provides that, in general, the term "parts or accessories" includes (1) any article the primary use of which is to improve, repair, replace, or serve as a component part of an automobile truck or bus chassis or body, or taxable tractor, (2) any article designed to be attached to or used in connection with such chassis, body, or tractor, to add to its utility or ornamentation, and (3) any article the primary use of which is in connection with such chassis, body, or tractor, whether or not essential to its operation or use. That section further provides, by way of example, that loading or unloading equipment designed to be attached to or to be primarily used in connection with a truck is a taxable part or accessory inasmuch as the article contributes to the load-carrying function of the truck.

Section 48.4061(b)-2(b) of the regulations provides that the term "parts or accessories" does not include articles which are not used primarily in the manufacture, repair, etc., of automobile trucks or tractors, but have a general use in the manufacture, repair, etc., of various articles. However, under the provisions of section 48.4061(b)-2(c) of the regulations, where material of a general nature is cut or otherwise transformed by any person into an automobile part or accessory, tax attaches at the time such part or accessory is sold by such person.

Accordingly, it is held that where articles of the type discussed in Revenue Ruling 69-143 are sold separately by the manufacturer thereof, such sales are subject to the tax imposed by section 4061(b)(1) of the Code, if the articles are designed for use or are primarily used with taxable tank bodies or any other articles enumerated in section 4061(a)(1).

Under the authority granted by section 7805(b) of the Code, this Revenue Ruling will not be applied to separate sales of accessorial equipment of the type discussed herein prior to January 1, 1970.

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26 CFR 48.4061(b)-2: Definition of parts or accessories.

Whether sales of certain truck refrigeration units are subject to the manufacturers excise tax on automobile parts or accessories. See Rev. Rul. 69-392, page 194.

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26 CFR 48.4061(b)-2: Definition of parts or accessories.

Whether sales of air-conditioning units designed for installation in trucks, buses, highway-type tractors, and passenger automobiles are subject to the manufacturers excise tax on automobile parts or accessories. See Rev. Rul. 69-578, page 199.

Section 4063.—Exemptions

Whether the exemption from manufacturers excise tax relating to bodies primarily designed to haul feed, seed, or fertilizer to and on farms applies to certain bulk feed bodies. See Rev. Rul. 69-579, page 200.

Part II—Tires and Tubes

Section 4071.—Imposition of Tax

26 CFR 48.4071-1: Imposition and rates of tax.
(Also Section 4072; 48.4072-1.)

Curing tubes used in retreading tires are not inner tubes subject to the tax imposed by section 4071(a)(3) of the Code.

Rev. Rul. 69-529

Advice has been requested regarding the applicability of the manufacturers excise tax imposed by section 4071(a)(3) of the Internal Revenue Code of 1954, to the sale of the curing tubes described below.

The curing tube is oval-shaped and made of special heat-resistant chlorobutyl rubber. The walls of the tube vary in thickness from 5/16 to 1/2 inch and the air valve is mounted in the center of the tube. A curing tube is distinguishable from a conventional inner tube which is round and has a wall thickness that varies from 1/32 to 1/16 of an inch. In the conventional tube the air valve is placed off center.

In the retreading operation the curing tube is inserted into a tire to be retreaded and a collapsible metal curing rim is placed on the inside diameter of the tube. The tire is then placed in a mold and the tube is inflated with sufficient air pressure to force the tire against the mold, thereby bonding the tread rubber to the tire and giving the recapped tire its tread design.

Section 4071(a)(3) of the Code imposes a tax upon sales of inner tubes for tires by the manufacturer, producer, or importer thereof. Section 48.4072-1(d) of the Manufacturers and Retailers Excise Tax Regulations defines "inner tubes" as including air containers of all types made wholly or in part of rubber and designed and manufactured for use in pneumatic tires.

Because of their design and construction, the described curing tubes are completely impractical for use as air containers for pneumatic tires. Accordingly, it is held that the tubes are not "inner tubes" within the meaning of the Code and regulations, and manufacturers' sales of such articles are not subject to the tax imposed by section 4071(a)(3) of the Code.

Section 4072.—Definitions

26 CFR 48.4072-1: Definitions.

Whether the manufacturers excise tax imposed by section 4071(a)(3) of the Code applies to sales of curing tubes. See Rev. Rul. 69-529, this page.

Part III—Petroleum Products

Subpart A—Gasoline

Section 4081.—Imposition of Tax

26 CFR 48.4081-1: Imposition and rates of tax.

Whether the exemption from manufacturers excise tax for articles sold to a nonprofit educational organization for its exclusive use is applicable to gasoline pur-

chased by employees of such an organization for use in their private automobiles when traveling on official business for the organization. See Rev. Rul. 69–396, page 214.

Subchapter D. Recreational Equipment

Part I—Sporting Goods

Section 4161.—Imposition of Tax

26 CFR 48.4161–1: Imposition and rate of tax.

Methods to be used in determining the taxable portion of the unit selling price where a taxable article and a nontaxable article are sold together at a single price, for purposes of computing the manufacturers excise taxes imposed under chapter 32 of the Code. See Rev. Rul. 69–394, this page.

26 CFR 48.4161–1: Imposition and rate of tax.

Computation of the manufacturers excise tax where a manufacturer sells articles otherwise than at arm's length to a related entity for the same price as it sells to independent dealers. See Rev. Rul. 69–568, page 209.

Part III—Firearms

Section 4181.—Imposition of Tax

26 CFR 48.4181–1: Imposition and rates of tax.

A company that distributes firearms of foreign manufacture is the "importer," for purposes of the manufacturers tax, where a domestic importing company is merely a conduit under a contractual agreement entered into by the three parties.

Rev. Rul. 69–393

Advice has been requested as to who is the "importer" of certain firearms for purposes of the manufacturers excise tax imposed by section 4181 of the Internal Revenue Code of 1954 in the situation described below.

X, a domestic corporation, distributes certain firearms with respect to which tax is imposed by section 4181 of the Code on the sale by a manufacturer, producer, or importer. The firearms acquired by *X* are nominally imported by *Y*, a domestic corporation, unrelated to *X*. *Z*, a foreign manufacturer, produces the firearms according to plans and specifications furnished by *X*.

The manufacture, importation, and sale of the firearms are governed by terms and conditions provided in an agreement between *X*, *Y*, and *Z* as contracting parties. Under the agreement *Y* has exclusive rights acquired from *X* to import firearms impressed with the *X* brand name. *X* agrees to supply American walnut stockwood blanks to *Z* at a specified price per blank. *Z* furnishes all other materials and labor in the production of the firearms and sells them to *Y* at prices that may be adjusted by a formula set forth in the contract. *X* has the right to have a resident inspector at *Z*'s plant with authority to reject any firearms prior to shipment that do not conform to the specifications furnished by *X*. The price from *Y* to *X* is the total landed cost including customs duty, ocean freight, marine insurance, etc., plus five percent.

Section 4181 of the Code imposes a tax upon the sale by the manufacturer, producer, or importer of firearms, shells, and cartridges.

An "importer" within the meaning of section 4181 of the Code is the person who has principal and not as agent arranges for, or is the inducing and efficient cause of, the firearms being brought into the United States for the purposes of sale or use by him. See Rev. Rul. 67–209, C.B. 1967–1, 297, and Rev. Rul. 68–197, C.B. 1968–1, 455.

For purposes of the manufacturers excise tax, it is necessary to look through the form to the substance of a transaction to determine whether a nominal importer actually functions as a typical import merchant, or merely serves in a representative capacity, charged only with the responsibility for bringing articles into the United States pursuant to a contract between the principals involved.

In the instant case, *Y* does not assume any of the risks of a typical merchant importer. *Y* serves merely as a conduit through which orders are transmitted to *Z* and through which firearms, when received, are transferred to *X*. The five percent added to the landed cost of the firearms is compensation for services rendered by *Y* as the corporate agent of *X*. Thus, *Y* merely handles the importation of the firearms into the United States and delivers them to *X*. The compensation for this service does not represent a return on *Y*'s capital investment achieved in open competition for the firearms market in the United States. Moreover, *X* supplies stockwood blanks to the foreign manufacturer, prescribes the specifications of the firearms, and retains the right to reject firearms that do not conform to such specifications prior to their shipment to the United States.

Under the circumstances described above, it is held that *X* is the importer of the firearms for purposes of the manufacturers excise tax. Accordingly, *X* is liable for the tax imposed by section 4181 of the Code on its sale of the firearms.

26 CFR 48.4181–1: Imposition and rates of tax.

Methods to be used in determining the taxable portion of the unit selling price where a taxable article and a nontaxable article are sold together at a single price, for purposes of computing the manufacturers excise taxes imposed under chapter 32 of the Code. See Rev. Rul. 69–394, this page.

26 CFR 48.4181–1: Imposition and rates of tax.

Computation of the manufacturers excise tax where a manufacturer sells articles otherwise than at arm's length to a related entity for the same price as it sells to independent dealers. See Rev. Rul. 69–568, page 209.

Subchapter F. Special Provisions Applicable to Manufacturers Tax

Section 4216.—Definition of Price

(Also Sections 4061, 4161, 4181; 26 CFR 48.4061(a)–1, 48.4061(b)–1, 48.4161–1, 48.4181–11.)

Methods of determining the manufacturers tax base where taxable and nontaxable articles are sold as a unit at a single price.

Rev. Rul. 69–394

The Internal Revenue Service has been asked how to compute the tax due

on the sale of articles subject to ad valorem manufacturers excise taxes, imposed under chapter 32 of the Internal Revenue Code of 1954, in situations where such articles are sold in combination with nontaxable articles.

Manufacturers frequently sell for a single price a combination consisting of a taxable article and a nontaxable article. In most cases, the manufacturer also sells the two articles separately and he thus has a separate established price for each. When he sells the two articles together, the price for the combination is normally less than the sum of the established separate prices. However, some manufacturers who sell such combinations never sell both articles separately and thus have not established a separate selling price for each article.

The various situations may be illustrated by the examples set forth below, each involving taxable articles with respect to which the tax rate is ten percent. It is assumed in the examples given that the combination sale prices and their related separate selling prices are wholesale prices, and that all such prices are prices at the same level of distribution.

Situation 1. A manufacturer wishes to sell a taxable article of his manufacture and a nontaxable article (which he either manufactured or purchased) in combination for $180 *plus* an amount equal to the tax due on the taxable portion of the combination. The manufacturer normally makes separate sales of the articles at established prices of $160 (tax excluded) for the taxable article and $40 for the nontaxable article.

Situation 2. A manufacturer wishes to sell a taxable article of his manufacture and a nontaxable article (which he either manufactured or purchased) in combination for $96 *plus* an amount equal to the tax due on the taxable portion of the combination. The manufacturer does not have established prices for separate sales of both articles. However, he has established that the actual costs of producing the articles (determined in accordance with generally accepted accounting principles) were $45 for the taxable article and $15 for the nontaxable article. (If the nontaxable article was purchased, the $15 represents his purchase price.)

Situation 3. A manufacturer wishes to sell a taxable article and a nontaxable article in combination for $208 *including* an amount equal to the tax due on the taxable portion of the combination. The manufacturer normally makes separate sales of the articles at established prices of $104 (tax excluded) for the taxable article and $156 for the nontaxable article.

Various sections of chapter 32 of the Code impose upon certain articles a tax amounting to a specified percent of the price for which the articles are sold by the manufacturer, producer, or importer thereof. In determining the price for which a taxable article is sold, under the definition provided in section 4216(a) of the Code, the amount of the tax is excluded, whether or not stated as a separate charge.

For purposes of determining the price for which the taxable article is sold under the circumstances described above, the single price for which the combination of two articles is sold must be apportioned between the taxable article and the nontaxable article. The tax applies only to that portion of the combination sale price properly attributable to the taxable article.

If the manufacturer regularly makes separate sales of both articles at established prices, it is held that the taxable portion of the combination is to be determined by applying to the manufacturer's tax-excluded sale price of the combination the ratio which the manufacturer's separate sale price of the taxable article (tax excluded) bears to the sum of the separate sale prices of the taxable article (tax excluded) and the nontaxable article. Thus, in *situation 1,* the combination price of $180 should be multiplied by a fraction determined by dividing $160 by $200 (⅘ or .8). The resulting $144 is the taxable portion of the combination sale price. The tax, computed at the rate of ten percent, is $14.40, and the tax-included price of the combination is $194.40.

If the manufacturer does not regularly make separate sales of both articles and therefore has no established separate prices, it is held that the taxable portion of the tax-excluded sale price of the combination is to be determined on the basis of the ratio that the actual cost of producing the taxable article bears to the sum of the actual costs of producing both the taxable and nontaxable articles. Accordingly, in *situation 2,* the combination price of $96 should be multiplied by a fraction determined by dividing $45 by $60 (¾ or .75). The resulting $72 is the taxable portion of the combination sale price. The tax is $7.20 and the tax-included price of the combination is $103.20.

From the foregoing, it will be noted that the tax-included price of each combination is made up of three distinct segments, illustrated as follows:

$$t+n+rt=S$$

"t" represents the portion of the tax-excluded price allocated to the taxable article (determined as explained above).

"n" represents the portion of the price allocated to the nontaxable article. (Thus, "t plus n" represents the tax-excluded price of the combination.)

"rt" represents the tax (applicable tax rate, "r," multiplied by "t").

"S" represents the tax-included price of the combination.

(Dollar amounts, percentages, or fractions, as appropriate, may be substituted for the symbols in applying the foregoing equation.)

If, as in *situation 3,* the tax-included price of the combination is known (rather than the tax-excluded price), the amount of the tax may be determined through use of a formula, stated and explained below.

$\frac{S}{1.00+rt}$ = The tax-excluded price of the combination.

In *situation 3*, the fractional part of the unknown tax-excluded single price of the combination that is represented by "t" is determined by dividing $104 by $260 (the sum of the separate prices). The result (.4) is multiplied by the tax rate (10%) to determine the fraction (.04) representing the tax. Then, $208 (the tax-included price of the combination, or "S") is divided by 1.04 (1.00 plus .04), resulting in $200, the tax-excluded price of the combination. The amount of the tax due on the combination sale is $8 ($208 minus $200).

(Also Sections 4061, 6416; 26 CFR 48.4061(a)–4, 48.6416(b)–2, 48.6416(b)–3.)

Application of the manufacturers tax imposed by sections 4061(a)(1) and 4061(b)(1) of the Code where a company arranges with a manufacturer to produce taxable bus bodies and furnishes the tax-paid chassis and body parts purchased from another manufacturer for use in producing the bus.

Rev. Rul. 69–437

Advice has been requested with regard to the application of the manufacturers excise taxes imposed on the sale of bus chassis and bodies by section 4061(a)(1) of the Internal Revenue Code of 1954, and on automotive parts or accessories by section 4061(b)(1), in the situation described below.

X is in the business of selling buses. In the situation in question, an order was placed with *X* for a bus having special features specified by the customer. *X* purchased the bus chassis and certain bus body parts from *Y*, the manufacturer of both the chassis and the body parts. *Y* reported and paid the manufacturers excise taxes imposed on the sale of the bus chassis and body parts by sections 4061(a)(1) and 4061(b)(1) of the Code, respectively.

Z is a manufacturer of specially designed automotive bodies. *X* contracted with *Z* to fabricate a complete bus body according to *X*'s specifications. For that purpose the bus chassis purchased from *Y* was furnished to *Z*. Under the terms of the *X*–*Z* contract, the body parts also were furnished to *Z*, the contract providing that *X* retained title to those parts. *Z* produced a bus body incorporating therein the body parts furnished by *X*, and mounted the body on the chassis supplied by *X*. The body parts supplied by *X* constituted only a minor portion of the total bus body produced by *Z*. The completed bus was delivered by *Z* to *X* for the contracted cash price.

The initial question raised by the foregoing factual situation is whether, for manufacturers excise tax purposes, the bus body has been manufactured by *X*, by reason of its contractual arrangement between *X* and *Z*, or by *Z*, since it actually fabricated the body. Such questions are ordinarily resolved by determining who has ownership of the end article when it has reached the stage of manufacture where it is recognized as a taxable article. In cases where it is not clear who owns the end article at the time of manufacture, one of the most important factors in determining who is the manufacturer is the relative values of material furnished by each of the parties to the transaction. In the instant case, if *X* had furnished most of the body parts, under circumstances indicating he had retained title thereto, *X* would be considered the manufacturer of the body, for manufacturers excise tax purposes. Because, however, *X*'s contribution of material is minimal, *Z* must be considered the manufacturer of the bus body.

After determining that *Z* is in fact the manufacturer of the bus body, other questions arise and these are specified below:

1. What is the proper tax base upon which to compute the manufacturers excise tax liability on *Z*'s sale of the bus body to *X*?

2. By reason of *Z*'s use of the tax-paid bus body parts in the manufacture of the body, is either *X* or *Z* entitled to a credit or refund of the tax paid on the parts, under the provisions of section 6416(b)(3)(B) of the Code?

3. By reason of *X*'s furnishing of bus body parts to *Z*, and *Z*'s use of such parts in further manufacture, is *Y* entitled to credit or refund of the tax paid on the parts, under the provisions of section 6416(b)(2)(E) of the Code?

Section 316.1(f) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C.B. 1954–2, 47, defines the term "sale" for purposes of the manufacturers excise tax as an agreement whereby the seller transfers the property (that is, the title or the substantial incidents of ownership) in goods to the buyer for a consideration called the price, which may consist of money, services, or other goods.

Section 6416(b)(3)(B) of the Code provides that tax paid under section 4061(b)(1) with respect to the sale of any article by the manufacturer thereof to a second manufacturer, shall be deemed to be an overpayment by such second manufacturer, if such article is used by the second manufacturer as material in the manufacture of, or as a component part of, any other article manufactured by him.

Section 6416(b)(2)(E) of the Code provides that tax paid under Chapter 32 in respect of any article shall be deemed to be an overpayment, if such article was, by any person, resold to a manufacturer for use by him in the manufacture of any other article manufactured by him.

In answer to the first question, pursuant to section 316.1(f) of Regulations 46, the price paid by *X* for the bus body manufactured by *Z* (and thus the tax included price upon which to compute the manufacturers excise tax liability on *Z*'s sale of the bus body to *X*), is the money that *X* agreed to pay *Z* for the body plus the value of the parts furnished by *X*, notwithstanding the provisions of the contract regarding retention of title to the parts. The value of such parts is the amount paid for them by *X*, excluding the manufacturers excise tax paid by *Y* on the sale of the parts.

With respect to the second question, section 6416(b)(3)(B) of the Code

provides for a credit or refund of manufacturers excise tax to a manufacturer who uses tax-paid automotive parts or accessories in the manufacture of any other article, provided the manufacturer of the end article has obtained the tax-paid parts or accessories by direct purchase from the manufacturer of the parts or accessories. Under the provisions of section 6416(b)(3)(B), neither the manufacturer, *Z*, nor his customer, *X*, is entitled to credit or refund of the manufacturers excise tax paid on the parts furnished by *X*. *Z* did not obtain the parts by direct purchase from the parts manufacturer, *Y*, and *X* did not itself use the parts in the manufacture of another article.

In answer to the third question, when the parts furnished by *X* to *Z* are incorporated into the bus body, the manufacturers excise tax paid on *Y*'s sale of the parts becomes an overpayment of tax under the provisions of section 6416(b)(2)(E) of the Code. The furnishing of the parts for incorporation into a bus body owned by *Z* is a resale of the parts, within the meaning of section 6416(b)(2)(E). Accordingly, *Y*, the manufacturer of the parts, is entitled to a credit or refund of the tax it paid on the sale of such parts. This credit or refund would, of course, be subject to the condition to allowance contained in section 6416(a) of the Code, and for purposes of that section, *X* is the "ultimate vendor" of the parts. See section 48.6416(a)-1(d)(2)(ii)(a) of the Manufacturers and Retailers Excise Tax Regulations for the applicable definition of "ultimate vendor."

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26 CFR 148.1–5: Constructive sale price. (Also Sections 4061, 4161, 4181; 48.4061(a)–1, 48.4061(b)–1, 48.4161–1, 48.4181–1).

Where a manufacturer sells taxable articles to a subsidiary and to unrelated dealers at the same prices, the manufacturers tax on sales to the subsidiary is computed on the intercompany price rather than a constructive sale price.

Rev. Rul. 69–568

Advice has been requested as to the computation of the manufacturers excise tax due on the sale of articles subject to ad valorem manufacturers excise taxes imposed under Chapter 32 of the Internal Revenue Code of 1954 in the situation described below.

X corporation is a manufacturer of articles subject to an ad valorem manufacturers excise tax imposed under Chapter 32 of the Code. *X* sells its own brand articles to independent dealers regularly and in substantial quantities. *X* also sells identical articles to *Y* corporation, its wholly-owned sales and distribution subsidiary, at the same prices as those charged the independent dealers.

Y has its own employees, place of business, adequate working capital, and property. In general, the relationship between the corporations is such as to indicate that *Y* operates separate and apart from *X*, and that the transactions between *X* and *Y* are valid sales for manufacturers excise tax purposes.

The question presented is whether section 4216(b)(1)(C) of the Code is applicable to the sales made by *X* to *Y*, so that the manufacturers excise tax must be computed on a constructive sale price, rather than on the intercompany sale price.

Section 4216(b)(1)(C) of the Code provides that if an article is sold otherwise than through an arm's length transaction *at less than the fair market price*, the manufacturers excise tax shall (if based on the price for which the article is sold) be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers and producers thereof, as determined by the Secretary of the Treasury or his delegate.

The relationship between *X* and *Y* is such that the intercompany sales are otherwise than at arm's length. Accordingly, if the intercompany sale price is also at less than the fair market price the provisions of section 4216(b)(1)(C) of the Code will be applicable in this case, and manufacturers excise tax liability will be computed on a constructive sale price determined by the Commissioner of Internal Revenue, rather than on the actual intercompany price.

An intercompany sale price is not less than the fair market price where additional bona fide sales of like articles bearing the same brand name are made by the manufacturer regularly and in substantial quantities to unrelated vendees at a price that is not in excess of the intercompany price. In such case, the manufacturers excise tax on the intercompany sale is to be computed on the actual sale price.

In the instant case, *X* sells taxable articles to *Y* at the same price it sells like articles to unrelated dealers. Accordingly, it is held that the intercompany price is not less than the fair market price of such articles and the basis for computing tax on the intercompany sales is the actual intercompany sale price.

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26 CFR 148.1–5: Constructive sale price. (Also Section 4061; 48.4061(a)–1.)

Constructive sale price to be used by a company manufacturing and selling heavy-duty truck chassis only on special order and at a price determined, in part, by the contractual negotiation in each individual case.

Rev. Rul. 69–580

The Internal Revenue Service has been asked to determine a constructive sale price, under the authority provided by section 4216(b)(1) of the Internal Revenue Code of 1954, for motor vehicle articles sold at retail under the circumstances described below.

A company is engaged in the manufacture and sale of heavy-duty truck chassis that are subject to the manufacturers excise tax imposed by section 4061(a)(1) of the Code. The company does not sell the chassis through independent dealers and does not maintain an inventory of truck chassis for sale. The chassis are manufactured

pursuant to special orders submitted by individual consumers through the company's regional salesmen. When placing an order, the customer selects one of several basic model truck chassis offered by the company and also supplies the company with information as to the conditions under which the truck chassis will operate and the specifications and options desired. The company furnishes the customer with price lists of the basic models but only as a starting point for purposes of negotiating the contract. The actual price charged by the company is based on its estimated cost plus a varying profit percentage. Since the manufacturer has a contract assuring sale of the finished chassis before going into production, the profit markup involved in this type of transaction is normally much lower than the markup involved where a company manufactures chassis and inventories them for future sale.

Section 4216(b)(1)(A) of the Code provides that if an article is sold at retail, the manufacturers excise tax shall (if based on the price for which the article is sold) be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Secretary of the Treasury or his delegate. The section further provides that, in the case of an article sold at retail, the computation shall be on whichever of the following prices is the lower: (i) the price for which such article is sold, or (ii) the highest price for which such articles are sold to wholesale distributors, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Secretary or his delegate.

Section 148.1–5(b)(1) of the temporary rules, Treasury Decision 6355, C.B. 1959–1, 795, provides that where a manufacturer, producer, or importer sells an article at retail, the tax on his retail sale ordinarily will be computed upon the highest price for which similar articles are sold by him to wholesale distributors. However, in such cases it must be shown that he has an established bona fide practice of selling such articles in substantial quantities to wholesale distributors. If he has no such sales to wholesale distributors, a fair market price will be determined by the Commissioner. In any case the price so determined shall not be in excess of the actual price for which the article is sold by him at retail.

Where a manufacturer does not sell similar articles to wholesale distributors, the constructive sale price for the manufacturer's sales of truck and trailer chassis at retail has been determined to be 75 percent of the established retail price of the chassis. See Rev. Rul. 54–61, C.B. 1954–1, 259.

In Revenue Ruling 68–519, C.B. 1968–2, 513, the problem of determining an "established retail price" was considered in a situation where articles are never sold by the manufacturer at the published retail list price, but always for less than list price. Revenue Ruling 68–519 holds that in such a situation the "established retail price" is the price resulting from the minimum discount off the retail list price. That Revenue Ruling also defines "established retail price" for purposes of section 4216(b)(1) of the Code as "the highest price for which a manufacturer sells or offers to sell a single article for use by an independent purchaser who would not ordinarily be expected to buy more than one."

Revenue Ruling 68–202, C.B. 1968–1, 477, covers a situation wherein a manufacturer of automotive chassis and bodies sells at retail under such circumstances that he does not have an "established retail price" for the articles. That Revenue Ruling holds that the constructive sale price (tax exclusive) in that situation is whichever of the following amounts is the higher: (1) 75 percent of the actual sale price (excluding the amount representing manufacturers excise tax), or (2) the total cost to manufacture and sell the chassis or body, plus ten percent.

The specific question presented in this case is whether (a) the facts are such that the manufacturer has available an "established retail price" so that the constructive sale price should be computed under the holding in Revenue Ruling 68–519, or (b) the facts are such that there is no "established retail price" and the constructive sale price should be computed under the holding in Revenue Ruling 68–202.

Although the company maintains list prices for its basic model truck chassis and for optional equipment, the actual selling price of the delivered chassis under a special order contract will always be less than, and will fluctuate irregularly from, the sum of the list prices for the basic model and the optional equipment. Consequently, there is absent from the circumstances in this case a regular selling pattern evidencing a "highest price for which the manufacturer regularly sells or offers to sell" taxable articles (a condition that was essential to the conclusion reached in Revenue Rulings 54–61 and 68–519). Furthermore, as indicated previously, the average profit markup in the type of transaction described in the instant case is substantially lower than in those cases where articles are manufactured and inventoried for sale without the benefit of prior contracts to sell, as in the situations contained in Revenue Rulings 54–61 and 68–519.

Accordingly, under the facts presented in the instant case there is no "established retail price" available, and it is held that the constructive sale price is to be computed under the method set forth in Revenue Ruling 68–202. Therefore, under the provisions of that Revenue Ruling, the constructive sale price (tax exclusive) to be used by the company is the higher of (1) 75 percent of the actual sale price charged the customer (excluding the amount representing manufacturers excise tax), or (2) the total cost to manufacture and sell the completed truck chassis, plus ten percent. The tax due is computed at the applicable statutory percentage of the higher of (1) or (2).

However, in any case in which application of the foregoing constructive sale price results in a tax that would exceed the tax based on the actual price

for which the chassis are sold, the tax should be computed on the price for which the chassis are sold.

Section 4218.—Use by Manufacturer or Importer Considered Sale

26 CFR 48.4218–1: Tax on use by manufacturer, producer, or importer.
(Also Sections 4061, 7805; 48.4061(a)–2, 301.7805–1.)

A United States resident who orders a foreign-made automobile from a vendor while temporarily in the foreign country and imports it for his personal use in the United States is liable for the manufacturers tax on motor vehicles; Revenue Ruling 65–317 amplified and Revenue Ruling 68–30 distinguished.

Rev. Rul. 69–598

Advice has been requested regarding the manufacturers excise tax consequences of the importation of a foreign-made automobile by a United States resident under the conditions described below.

A United States resident, while temporarily in a foreign country, ordered from a foreign vendor a foreign-made automobile not previously sold in the United States. Under the terms of the sales contract, ownership of the automobile passed to the purchaser when the vehicle was placed aboard a vessel for shipment to the United States. When the automobile arrived at the designated port in the United States, the purchaser cleared the vehicle through customs for his personal use.

Section 4061(a)(2) of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer, producer, or importer of automobile chassis and bodies other than those taxable under section 4061(a)(1) of the Code.

Section 4218(a) of the Code provides that if any person manufactures, produces, or imports an article (other than specified articles not involved here) and uses it (otherwise than as material in the manufacture or production of, or as a component part of, another article taxable under chapter 32 of the Code, to be manufactured or produced by him) he is liable for tax under chapter 32 in the same manner as if such article were sold by him.

Section 48.4218–2(b) of the Manufacturers and Retailers Excise Tax Regulations provides that the tax on use of a taxable article imposed by section 4218 of the Code shall not apply to an individual who incidentally manufactures, produces, or imports a taxable article for his personal use or causes a taxable article to be manufactured, produced, or imported for his personal use.

Revenue Ruling 65–317, C.B. 1965–2, 422, describes two situations involving the importation by a United States resident of a foreign-made automobile that had not previously been sold in the United States. In each of the cases described the United States resident acquired ownership of the vehicle without leaving the country. Revenue Ruling 65–317 concludes that in both cases the automobile was not "incidentally" imported for personal use within the meaning of section 48.4218–2(b) of the regulations because the facts in each situation do not reflect any primary purpose to which the importation could be attributed as incidental. Therefore, the Revenue Ruling holds that the United States resident is liable for the tax imposed by section 4061(a)(2) of the Code upon his use of the imported vehicle.

Similarly, under the circumstances of the instant case, it is held that the United States resident is liable for the tax imposed by section 4061(a)(2) of the Code upon his use of the imported automobile. The fact that he is in a foreign country when he orders (or pays a foreign vendor or a domestic agency or its overseas branch for) the foreign-made vehicle does not in itself preclude the application of the tax imposed by section 4061(a) of the Code if the acquisition of the vehicle for use in the United States is the primary objective of the transaction involving the purchase of the automobile.

Under the authority granted by section 7805(b) of the Code, this Revenue Ruling will be applied only as to articles taxable under section 4061(a) of the Code imported on or after February 1, 1966. In this connection see Revenue Ruling 65–317.

Revenue Ruling 68–30, C.B. 1968–1, 481, is distinguishable from this case in that in each of the situations described in that Revenue Ruling the transaction calls for the purchaser to take possession of the foreign-made automobile within a foreign country prior to its importation into the United States.

Revenue Ruling 65–317 is hereby amplified; Revenue Ruling 68–30 is hereby distinguished.

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26 CFR 48.4218–5: Computation of tax.
(Also Section 4061; 48.4061(a)–1.)

The tax base for computing the manufacturers tax on a foreign made automobile imported by an individual for personal use in the United States is the attributed entry valuation for import duty plus other importation costs; Rev. Ruls. 66–66 and 67–56 revoked, Rev. Rul. 68–30 modified.

Rev. Rul. 69–640

The Internal Revenue Service has reconsidered Revenue Ruling 66–66, C.B. 1966–1, 252, relating to computation of the manufacturers excise tax imposed by section 4061(a)(2) of the Internal Revenue Code of 1954, in situations where an individual is the taxpayer as a result of importing and using a foreign-made automobile. See Revenue Ruling 65–317, C.B. 1965–2, 422, and Revenue Ruling 68–30, C.B. 1968–1, 481, for examples of such situations.

Revenue Ruling 66–66 holds that the manufacturers excise tax base in the described situations is the total cost of acquisition of the vehicle. Revenue Ruling 67–56, C.B. 1967–1, 295, clarifies the term "total cost of acquisition" as it is used in Revenue Ruling 66–66.

Section 4061(a)(2) of the Code imposes a tax upon the sale by the manu-

facturer, producer, or importer of automobile chassis and bodies other than those taxable under section 4061 (a) (1) of the Code. A sale of an automobile, for purposes of section 4061 (a) (2) of the Code, is considered to be a sale of a chassis and of a body.

Section 4218(a) of the Code provides that if any person manufactures, produces, or imports an article (other than specified articles not involved herein) and uses it (otherwise than as material in the manufacture or production of, or as a component part of, another article taxable under chapter 32 to be manufactured or produced by him), he is liable for tax under chapter 32 in the same manner as if such article were sold by him.

Section 4218(e) of the Code provides that in any case (other than situations in which section 4223(b) applies) in which a person is made liable for a use tax under section 4218, the tax (if based upon the price for which the article is sold) shall be computed on the price at which such or similar articles are sold, in the ordinary course of trade, by manufacturers, producers, or importers, thereof, as determined by the Secretary of the Treasury or his delegate.

Section 48.4218–5(b) of the Manufacturers and Retailers Excise Tax Regulations provides that if the manufacturer, producer, or importer of an article does not regularly sell such articles at wholesale in arm's length transactions, a constructive price (tax base) on which the tax shall be computed will be determined by the Commissioner after considering the selling practices and price structures of manufacturers, producers, and importers of similar articles.

Upon reconsideration, it is held that the manufacturers excise tax base on the use of an imported automobile in the described situations is an amount equal to the sum of (1) the entry valuation attributed to the automobile for the purpose of imposing an import duty, (2) the import duty itself, (3) customs handling fees, (4) ocean freight, and (5) any other costs incurred in connection with importing the automobile. The tax base does not include state and local use taxes, fees paid for registration or license tags under state law, or any other fee required to be paid for the privilege of operating the automobile on public highways.

If the foreign-made automobile has been imported duty free (e.g., by a member of the Armed Forces of the United States returning home upon termination of his assignment), it is held that the tax base is an amount equal to the tax base for similar dutiable entries (as discussed above). This would include an amount equal to an import duty that would otherwise apply. In such cases the importer must establish the entry valuation otherwise attributable to the automobile at the time of importation.

Where parties other than the importer assume responsibility for payment, or reimbursement, of a normal importing expense (such as ocean freight and customs handling fees), an amount equal to such expense must be included in the tax base.

Revenue Ruling 66–66 and Revenue Ruling 67–56 are hereby revoked. Revenue Ruling 68–30 is hereby modified to remove therefrom the next-to-last paragraph regarding computation of the tax.

Subchapter G. Exemptions, Registration, Etc.

Section 4221.—Certain Tax-Free Sales

(Also Section 4061; 26 CFR 48.4061(a)–1.)

Manufacturer's tax does not apply to automobiles and trucks delivered to the purchaser at the factory and then driven direct to the Canadian border or loaded on a truck and delivered to a port for embarkation to a foreign country; S.T. 833 superseded.

Rev. Rul. 69–395 [1]

The purpose of this Revenue Ruling is to update and restate under current law the conclusions set forth in S.T. 833, C.B. XV–1, 418 (1936). The issue involved is whether the automobile and truck in the situations set forth below are exported "before any other use" within the meaning of section 4221(a)(2) of the Internal Revenue Code of 1954.

Situation 1. An automobile sold tax free for export is delivered to the purchaser at the factory. The purchaser loads his luggage and other belongings in the automobile and then drives it to a point on the Canadian border for entry into that country.

Situation 2. An automobile and truck both sold tax free for export are delivered to the purchaser at the factory. The automobile is loaded on the truck and the truck is then driven to a port of the United States for embarkation to a foreign country.

Section 4221(a) of the Code provides that under regulations prescribed by the Secretary of the Treasury or his delegate, no manufacturers excise tax shall be imposed under chapter 32 of the Code on the sale by the manufacturer of an article for export, or for resale by the purchaser to a second purchaser for export, but only if such exportation is to occur before any other use.

Section 316.25(a) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C.B. 1954–2, 47, provides that to exempt from tax a sale for export, it is necessary that two conditions be met, namely, (1) that the article be identified as having been sold by the manufacturer for export, and (2) that it be exported in due course. The regulations further provide that an article will be regarded as having been sold by the manufacturer for export if the manufacturer has in his possession at the time title passes or at the time of shipment (whichever is prior), where delivery by the manufacturer is to be made within the United States, a statement from the purchaser showing that such article will be transported to its foreign destination in due course prior to use or

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

further manufacture and prior to any resale except for export.

Automobile and trucks sold, delivered, and driven under the circumstances of the instant case are considered to have been exported before any other use and in due course within the meaning of the law and regulations cited above, provided that (1) the automobile or truck is not used for any purpose other than being driven from the factory to the point of exportation, (2) the time intervening between delivery at the factory and arrival at the point of exportation is devoted to reaching such point, and (3) the evidence required by the regulations is furnished. The time or mileage involved in making the trip is not important as long as the automobile or truck is driven directly from the factory to the place of exportation without delay and is not used for any other purpose, as, for example, making a tour or visiting places of interest in the United States.

In *Situation 1,* the automobile is not considered to have been used in the United States for any purpose other than that incident to exportation. In that case, the provisions of section 4221(a)(2) of the Code were satisfied and it is held that the tax was not incurred by the manufacturer. The merchandise that may be transported in the automobile without destroying the exemption is limited to the personal baggage of the passengers.

Likewise, in *Situation 2,* the truck is not considered to have been used in the United States for any purpose other than that incident to exportation. In this situation also it is held that the tax was not incurred by the manufacturer.

S.T. 833 is hereby superseded, since the conclusion thereof is restated under current law in this Revenue Ruling.

(Also Section 4041; 26 CFR 48.4041–9.)

Finland has been added to the list of countries which allow substantially reciprocal privileges for purposes of the exemption relating to supplies for civil aircraft of foreign registry; Revenue Ruling 63–62 supplemented.

Rev. Rul. 69–404

Revenue Ruling 63–62, C.B. 1963–1, 250, as modified by Revenue Ruling 63–230, C.B. 1963–2, 539, and Revenue Ruling 67–193, C.B. 1967–1, 306, and as supplemented by Revenue Ruling 64–228, C.B. 1964–2, 437, and Revenue Ruling 68–229, C.B. 1968–1, 483, sets forth a list of foreign countries that the Secretary of Commerce has determined allow substantially reciprocal privileges in respect of aircraft registered in the United States, for purposes of the special rule provided by section 4221(e)(1) of the Internal Revenue Code of 1954. That special rule relates to excise tax exemptions with respect to articles sold for use as supplies for civil aircraft registered in a foreign country and employed in foreign trade or trade between the United States and any of its possessions.

The Secretary of the Treasury has been advised by the Secretary of Commerce that he has determined that Finland also allows substantially reciprocal privileges in respect of aircraft registered in the United States. Therefore, the list of countries that have been found to allow substantially reciprocal privileges should include "Finland."

Revenue Ruling 63–62 is hereby supplemented.

(Also Sections 4055, 4292; 26 CFR 42.-4292–1.)

An independent, nonprofit visiting nurse association providing nursing services to home-care patients does not come within the scope of the exemptions provided with respect to States and political subdivisions.

Rev. Rul. 69–438

Advice has been requested whether the association described below comes within the scope of the exemptions from certain Federal excise taxes provided with respect to States and political subdivisions.

An independent, nonprofit visiting nurse association provides nursing services to home-care patients. The association has a staff of registered nurses, practical nurses, and home-health aides. The operating costs are offset by contributions, nominal fees for services rendered, and income from endowment funds.

Section 4055 of the Internal Revenue Code of 1954 provides that the retailers excise taxes do not apply to the sale of any article for the exclusive use of any State, Territory of the United States, or any political subdivision of any of the foregoing, or the District of Columbia, or with respect to the use by any of the foregoing of any liquid as a fuel.

Section 4221(a)(4) of the Code provides that the manufacturers excise taxes do not apply to the sale of any article to a State or local government for the exclusive use of a State or local government.

Section 4292 of the Code provides that no tax applies to payments received for communication or transportation services or facilities furnished to the Government of any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia.

The association under consideration is not a state or local governmental organization and it does not perform a function traditionally a responsibility of a local government. Therefore, articles sold to the association are not sold for the exclusive use of a State or political subdivision thereof within the meaning of the applicable provisions of the Code. Likewise, services or facilities furnished to the association are not furnished to a State or political subdivision within the meaning of the statute.

Accordingly, the exemptions from the retailers excise taxes and the manufactures excise taxes, provided by sections 4055 and 4221(a)(4), respectively, of the Code, do not apply to sales of taxable articles to the association or to the use of such articles by the association. Furthermore, the ex-

emption from communication and transportation excise taxes, provided by section 4292 of the Code, does not apply to any amounts paid by the association for communication or transportation services or facilities furnished to it.

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26 CFR 148.1–4: Tax-free sales or services to certain nonprofit educational organizations.
(Also Sections 4081, 6416; 48.4081–1, 48.6416(b)–2.)

Gasoline sales to employees of a nonprofit educational organization when traveling on official business are not sales for the exclusive use of the organization, for purposes of the exemption from the manufacturers tax, if such employees are reimbursed on a mileage basis for the use of their automobiles.

Rev. Rul. 69–396

Advice has been requested whether sales of gasoline made under the circumstances described below are sales to a nonprofit educational organization for its exclusive use, for purposes of the exemption from the manufacturers excise tax provided in section 4221(a)(5) of the Internal Revenue Code of 1954.

Employees of a nonprofit educational organization use their own automobiles when traveling on official business for the organization, and are reimbursed for such use on a mileage basis. The organization obtains credit cards from a gasoline producer for use by the employees in purchasing gasoline. The organization pays the gasoline producer and deducts the cost of the gasoline from the salary or expense allowances of the employees.

Section 4081(a) of the Code imposes a tax on gasoline sold by the producer or importer thereof, or by any producer of gasoline.

Section 4221(a)(5) of the Code provides that no manufacturers excise tax shall be imposed on the sale by the manufacturer of an article to a nonprofit educational organization for its exclusive use but only if such use is to occur before any other use. Section 4221(d)(1) of the Code provides that for purposes of this section of the Code the term "manufacturer" includes a producer or importer of an article.

Under the provisions of section 6416(b)(2)(D) of the Code, if an article is sold by any person to a nonprofit educational organization for its exclusive use, the manufacturers excise tax paid in respect of such article shall be deemed to be an overpayment, and a credit or refund (without interest) shall be allowed or made in respect of such overpayment.

Revenue Ruling 138, C.B. 1953–2, 432, holds that sales of gasoline by the manufacturer or producer thereof to employees and officers of a State, or political subdivision thereof, who receive reimbursement from such State or political subdivision for the actual cost of the gasoline purchased for use in their own vehicles used in the performance of their official duties, are sales for the exclusive use of a State or political subdivision thereof and accordingly are exempt from tax. That Revenue Ruling further concludes, however, that if the employees and officers are paid on a per diem or per mile basis, the sales of gasoline to them are not considered to be sales for the exclusive use of a State, or political subdivision thereof.

The principles stated in Revenue Ruling 138 are equally applicable to gasoline sold to nonprofit educational organizations for their exclusive use in the same manner as gasoline sold for the exclusive use of a State or local government. Accordingly, where gasoline is sold by the producer thereof to employees of a nonprofit educational organization and the organization reimburses the employees for the actual cost of the gasoline purchased for use in their own automobiles when performing their official duties, the sales are considered sales to a nonprofit educational organization for its exclusive use. However, if the organization reimburses the employees on a per diem or per mile basis, the sales of the gasoline are not considered to be for the exclusive use of the nonprofit educational organization.

In the instant case, although the nonprofit educational organization arranges for the furnishing of gasoline to its employees through the use of credit cards issued in its name, the employees are in effect paying for the gasoline themselves through deductions in their salaries or adjustments in their expense allowances. Therefore, it is held that the gasoline is not sold to the nonprofit educational organization for its exclusive use within the meaning of section 4221(a)(5) of the Code or for purposes of the credit or refund provisions of section 6416(b)(2)(D).

Chapter 33—Facilities and Services

Subchapter B. Communications

Section 4251.—Imposition of Tax

Whether the absence of consents to the allowance of a refund of an overpayment of facilities and services excise taxes makes a timely filed claim defective, so far as timely filing is concerned. See Rev. Rul. 69–508, page 262.

Subchapter C. Transportation of Persons by Air

Section 4261.—Imposition of Tax

Whether the absence of consents to the allowance of a refund of an overpayment of facilities and services excise taxes makes a timely filed claim defective, so far as timely filing is concerned. See Rev. Rul. 69–508, page 262.

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26 CFR 49.4261–1: Imposition of tax; in general.

Whether any part of an airline flight between Seattle, Washington and Anchorage, Alaska with an intermediate stop at Sitka, Alaska is exempt from the tax on transportation of persons. See Rev. Rul. 69–507, below.

Section 4262.—Definition of Taxable Transportation

26 CFR 49.4262(a)–1: Taxable transportation.
(Also Section 4261; 49.4261–1.)

Applicability of the transportation tax to an airline flight between

Seattle, Washington and Anchorage, with an intermediate stop at Sitka, Alaska, where portions of the flight are over Canadian territory and international waters.

Rev. Rul. 69–507

Advice has been requested as to the portion of a certain airline flight to Alaska that is "taxable transportation" for purposes of the tax imposed by section 4261 of the Internal Revenue Code of 1954 on amounts paid for transportation of persons.

The flight in question originates in Seattle, Washington, and terminates in Anchorage, Alaska, with an intermediate stop at Sitka, Alaska. A portion of the flight between Seattle and Sitka is over Canadian territory, and a portion of the flight from Sitka to Anchorage is over international waters.

Section 4261(a) of the Code imposes a tax upon the amount paid within the United States for "taxable transportation" (as defined in section 4262 of the Code) of any person by air.

Section 4262(a) of the Code defines taxable transportation as (1) transportation which begins in the United States or in the 225-mile zone and ends in the United States or in the 225-mile zone, and (2) in the case of transportation other than transportation described in (1), that portion of such transportation which is directly or indirectly from one port or station in the United States to another port or station in the United States, but only if such portion is not a part of uninterrupted international air transportation. Section 4262(b) of the Code excludes from the definition of "taxable transportation" that portion of any transportation which meets all four of the following requirements:

(1) such portion is outside the United States;

(2) neither such portion nor any segment thereof is directly or indirectly—

(A) between (i) a point where the route of the transportation leaves or enters the continental United States, or (ii) a port or station in the 225-mile zone, and

(B) a port or station in the 225-mile zone;

(3) Such portion—

(A) begins at either (i) the point where the route of the transportation leaves the United States, or (ii) a port or station in the 225-mile zone, and

(B) ends at either (i) the point where the route of the transportation enters the United States, or (ii) a port or station in the 225-mile zone; and

(4) a direct line from the point (or the port or station) specified in paragraph (3)(A), to the point (or the port or station) specified in paragraph (3)(B), passes through or over a point which is not within 225 miles of the United States.

Section 49.4262(b)–1(b) of the Facilities and Services Excise Tax Regulations provides that under section 4262(b) of the Code transportation between the continental United States or the 225-mile zone and Alaska is partially exempt from the tax. The exemption applies to that portion of the transportation which is outside the United States, is not transportation between ports or stations within the continental United States or the 225-mile zone, and is not transportation between ports or stations within Alaska, because such transportation meets all the requirements of section 4262(b) of the Code.

It is held that the portion of the flight between Seattle and Sitka that is over Canadian territory is exempt transportation of persons by air because it (1) is outside the United States, (2) is not transportation between ports or stations within the continental United States or the 225-mile zone, and (3) is not transportation between ports or stations within Alaska. It is further held that the portion of the flight between Sitka and Anchorage does not qualify for the exemption, even though a portion of the flight is over international waters, because it is transportation between ports or stations within Alaska.

Subchapter E. Special Provisions Applicable to Services and Facilities Taxes

Section 4292.—State and Local Governmental Exemption

26 CFR 42.4292–1: State and local government exemptions.

Whether an independent, nonprofit visiting nurse association comes within the scope of the exemption relating to States and local governments. See Rev. Rul. 69-438, page 213.

Chapter 39—Regulatory Taxes

Subchapter A. Narcotic Drugs and Marihuana

Part I—Narcotic Drugs

Subpart A—Tax on Opium, Isonipecaine, Opiates, and Coca Leaves

Section 4702.—Exemptions

26 CFR 151.424: Conditions of exemption for Class "X" products.

T.D. 7017 [1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER 39, SUBCHAPTER A, PART 151.—REGULATORY TAXES ON NARCOTIC DRUGS

Excepted narcotic pharmaceutical preparations

On September 10, 1969, a notice was published in the Federal Register (34 F.R. 14224) stating that the Director, Bureau of Narcotics and Dangerous Drugs, pursuant to the provisions of section 4702(a)(3) of the Internal Revenue Code of 1954, as amended by section 4(c) of the Narcotics Manufacturing Act of 1960 (74 Stat. 58); § 151.426 of Title 26 of the Code of Federal Regulations; and under the authority vested in the Attorney General by Reorganization Plan No. 1 of 1968 (33 F.R. 5611) and redelegated to the Director, Bureau of Narcotics and Dangerous Drugs by § 0.200 of Title 28 of the Code of Federal Regulations, proposed certain additional restrictions on the retail sales of Class "X" exempt pharmaceutical preparations.

After due notice and opportunity for public hearing, and after consideration of all comments received on the proposed new restrictions, it is hereby found that the proposed regulations are necessary to restrict the existing abusive use of Class "X" exempt pharmaceutical preparations and to insure that such preparations are used for medicinal purposes only.

[1] 34 F.R. 17106.

375–738 O—70——16

Therefore, § 151.424 of Title 26 of the Code of Federal Regulations is hereby amended by adding to the existing section the following new paragraphs:

§ 151.424 Conditions of exemption for Class "X" products.

* * * * *

(d) *Retail sale restrictions.* A Class "X" product may only be sold at retail without a prescription by a registered pharmacist and not by a nonpharmacist employee even if under the direct supervision of a pharmacist. However, after the pharmacist has fulfilled his professional and legal responsibilities set forth in this section, the actual cash, credit transaction, or delivery, may be completed by a nonpharmacist. A pharmacist must exercise professional discretion in the sale of a Class "X" product to insure that the product is being sold for medical purposes only. An abuse of such discretion shall subject the pharmacist to the penalties provided for violations of the law relating to narcotic drugs.

(e) *Age of purchaser and identification.* A Class "X" product may only be sold at retail without a prescription to a person at least 18 years of age. The pharmacist must require every retail purchaser of a Class "X" product to furnish suitable identification, including proof of age when appropriate, in order to purchase a Class "X" product. The name and address obtained from such identification shall be entered in the record of disposition to consumers required by paragraph (b)(2) of this section.

(f) *Quantity restrictions.* Not more than 2 ounces of camphorated opium tincture (paregoric), not more than 3 ounces of any other Class "X" product containing opium, nor more than 4 ounces of any other Class "X" product, may be sold at retail to the same consumer in any given 48-hour period without a prescription.

Effective date. These amendments shall become effective on November 1, 1969.

Dated: October 11, 1969.

[SEAL] JOHN E. INGERSOLL,
Director, Bureau of Narcotics and Dangerous Drugs, Department of Justice.
RANDOLPH W. THROWER,
Commissioner, Internal Revenue Service, Department of the Treasury.

Approved October 16, 1969.

EDWIN S. COHEN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on Oct. 21, 1969; 8:45 a.m., and published in the issue of the Federal Register for Oct. 22, 1969, 34 F.R. 17106)

Part II—Marihuana

Subpart A—Tax on Transfers

Section 4744.—Unlawful Possession

A timely and proper assertion of the constitutional privilege against self-incrimination is a complete defense to a criminal prosecution based on unlawful possession of marijuana by a transferee without having paid the transfer tax imposed by section 4741(a) of the Code.

Ct. D. 1928

SUPREME COURT OF THE UNITED STATES

No. 65.—October Term, 1968.

Timothy F. Leary, Petitioner

v.

United States

[395 U.S. 6]

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

[May 19, 1969]

MR. JUSTICE HARLAN delivered the opinion of the Court.

This case presents constitutional questions arising out of the conviction of the petitioner, Dr. Timothy Leary, for violation of two federal statutes governing traffic in marijuana.

The circumstances surrounding petitioner's conviction were as follows. On December 20, 1965, petitioner left New York by automobile, intending a vacation trip to Yucatan, Mexico. He was accompanied by his daughter and son, both teenagers, and two other persons. On December 22, 1965, the party drove across the International Bridge between the United States and Mexico at Laredo, Texas. They stopped at the Mexican customs station and, after apparently being denied entry, drove back across the bridge. They halted at the American secondary inspection area, explained the situation to a customs inspector, and stated that they had nothing from Mexico to declare. The inspector asked them to alight, examined the interior of the car, and saw what appeared to be marijuana seeds on the floor. The inspector then received permission to search the car and passengers. Small amounts of marijuana were found on the car floor and in the glove compartment. A personal search of petitioner's daughter revealed a silver snuffbox containing semi-refined marijuana and three partially smoked marijuana cigarettes.

Petitioner was indicted and tried before a jury in the Federal District Court for the Southern District of Texas, on three counts. First, it was alleged that he had knowingly smuggled marijuana into the United States, in violation of 21 U.S.C. § 176a.[1] Second,

[1] Insofar as here relevant, 21 U.S.C. § 176a provides:

"Notwithstanding any other provision of law, whoever, knowingly, and with intent to defraud the United States, imports or brings into the United States marijuana contrary to law, or smuggles or clandestinely introduces into the United States marijuana which should have been invoiced, or receives, conceals, buys, sells, or in any manner facilitates the transportation, concealment, or sale of such marijuana after being imported or brought in, knowing the same to have been imported or brought into the United States contrary to law, or whoever conspires to do any of the foregoing acts, shall be imprisoned * * *.

"Whenever on trial for a violation of this subsection, the defendant is shown to have or to have had the marijuana in his possession, such possession shall be deemed sufficient evidence to authorize conviction unless the defendant explains his possession to the satisfaction of the jury."

it was charged that he had knowingly transported and facilitated the transportation and concealment of marijuana which had been illegally imported or brought into the United States, with knowledge that it had been illegally imported or brought in, all again in violation of § 176a.[2] Third, it was alleged that petitioner was a transferee of marijuana and had knowingly transported, concealed, and facilitated the transportation and concealment of marijuana, without having paid the transfer tax imposed by the Marijuana Tax Act, 26 U.S.C. § 4741 *et seq.*, thereby violating 26 U.S.C. § 4744(a)(2).[3]

After both sides had presented their evidence and the defense had moved for a judgment of acquittal, the District Court dismissed the first or smuggling count.[4] The jury found petitioners guilty on the other two counts. He was tentatively sentenced to the maximum punishment, pending completion of a study and recommendations to be used by the District Court in fixing his final sentence.[5] On appeal, the Court of Appeals for the Fifth Circuit affirmed. 383 F. 2d 851 (1967). That court subsequently denied a petition for rehearing and rehearing *en banc*. 392 F. 2d 220 (1968).

We granted certiorari, 392 U.S. 903 (1968), to consider two questions: (1) whether petitioner's conviction for failing to comply with the transfer tax provisions of the Marijuana Tax Act violated his Fifth Amendment privilege against self-incrimination; (2) whether petitioner was denied due process by the application of the part of 21 U.S.C. § 176a which provides that a defendant's possession of marijuana shall be deemed sufficient evidence that the marijuana was illegally imported or brought into the United States, and that the defendant knew of the illegal importation or bringing in, unless the defendant explains his possession to the satisfaction of the jury. For reasons which follow, we hold in favor of the petitioner on both issues and reverse the judgment of the Court of Appeals.

I.

We consider first petitioner's claim that his conviction under the Marijuana Tax Act violated his privilege against self-incrimination.

A.

Petitioner argues that reversal of his Marijuana Tax Act conviction is required by our decisions of last Term in *Marchetti* v. *United States*, 390 U.S. 39 (1968) [Ct. D. 1919, C.B. 1968–1, 500], *Grosso* v. *United States*, 390 U.S. 62 (1968) [Ct. D. 1918, C.B. 1968–1, 495], and *Haynes* v. *United States*, 390 U.S. 85 (1968) [Ct. D. 1920, C.B. 1968–1, 615]. In *Marchetti*, we held that a plea of the Fifth Amendment privilege provided a complete defense to a prosecution for failure to register and pay the occupational tax on wagers, as required by 26 U.S.C. §§ 4411–4412. We noted that wagering was a crime in almost every State, and that 26 U.S.C. § 6107 required that lists of wagering taxpayers be furnished to state and local prosecutors on demand. We concluded that compliance with the statute would have subjected petitioner to a " 'real and appreciable' " [6] risk of self-incrimination. We further recognized that the occupational tax was not imposed in " 'an essentially non-criminal and regulatory area * * *,' " 390 U.S., at 57,[7] but was "directed to a 'selective group inherently suspect of criminal activities.' " [8] We found that it would be inappropriate to impose restrictions on use of the information collected under the statute—a course urged by the Government as a means of removing the impact of the statute upon the privilege against self-incrimination—because of the evident congressional purpose to provide aid to prosecutors. We noted that, unlike the petitioner in *Shapiro* v. *United States*, 335 U.S. 1 (1948), Marchetti was not required to supply information which had a "public aspect" or was contained in records of the kind he customarily kept.

In *Grosso*, we held that the same considerations required that a claim of the privilege be a defense to prosecution under 26 U.S.C. § 4401, which imposes an excise tax on proceeds from wagering. And in *Haynes* we held for the same reasons that assertion of the Fifth Amendment privilege provided a defense to prosecution for possession of an unregistered weapon under the National Firearms Act, 26 U.S.C. § 5851, despite the fact that in "uncommon" instances registration under the statute would not be incriminating. See 390 U.S., at 96–97, 99.

B.

In order to understand petitioner's contention that compliance with the Marijuana Tax Act would have obliged him to incriminate himself within the meaning of the foregoing decisions, it is necessary to be familiar with the statutory scheme. The Marijuana Tax Act has two main subparts.

[2] See n. 1, *supra*.

[3] Insofar as here relevant, 26 U.S.C. § 4744(a) provides:

"It shall be unlawful for any person who is a transferee required to pay the transfer tax imposed by section 4741(a)—

"(1) to acquire or otherwise obtain any marijuana without having paid such tax, or

"(2) to transport or conceal, or in any manner facilitate the transportation or concealment of any marijuana so acquired or obtained."

The statutory scheme of the Marijuana Tax Act is analyzed in more detail at pp. 5–7, *infra*.

[4] Petitioner had testified without contradiction that he had obtained the marijuana in New York, and the District Court apparently reasoned that an article taken out of the United States could not be "smuggled" back into the country, as charged by the indictment. See Joint Appendix 60a; 2 Transcript of Record 520, 695; cf. *United States* v. *Claybourn*, 180 F. Supp. 448, 451–452 (1960).

[5] See 18 U.S.C. § 4208. Petitioner was tentatively sentenced to 20 years in prison and a $20,000 fine for violation of § 176a, and to 10 years in prison and a $20,000 fine for violation of § 4744(a)(2) (see 26 U.S.C. § 7237(a)), the prison sentences to run consecutively. The lowest penalty for conviction under § 176a is five years' imprisonment, and no suspension of sentence, probation, or parole is permitted following such a conviction. See 26 U.S.C. § 7237(d).

[6] 390 U.S., at 48, quoting from *Reg.* v. *Boyes*, 1 B. & S. 311, 330 (1861).

[7] 390 U.S., at 57, quoting from *Albertson* v. *SACB*, 382 U.S. 70, 79 (1965).

[8] 390 U.S., at 57, quoting from the same source.

The first imposes a tax on transfers of marijuana, the second an occupational tax upon those who deal in the drug. It is convenient to begin with the occupational tax provisions, 26 U.S.C. §§ 4751–4753.

Section 4751 provides that all persons who "deal in" marijuana shall be subject to an annual occupational tax. Subsections require that specified categories of persons, such as importers, producers, physicians, researchers, and millers pay varying rates of tax per year. See §§ 4751 (1)–(4), (6). Persons who "deal in" marijuana but do not fall into any of the specified categories are required to pay $3 per year. See § 4751(5). Section 4753 provides that at the time of paying the tax the taxpayer must "register his name or style and his place or places of business" at the nearest district office of the Internal Revenue Service.

The first of the transfer tax provisions, 26 U.S.C. § 4741, imposes a tax "upon all transfers of marijuana which are required by § 4742 to be carried out pursuant to written order forms." Section 4741 further provides that on transfers to persons registered under § 4753 the tax is $1 per ounce, while on transfers to persons not so registered the tax is $100 per ounce. The tax is required to be paid by the transferee "at the time of securing each order form." [9] With certain exceptions not here relevant,[10] § 4742 makes it unlawful for any person, "whether or not required to pay a special tax and register under sections 4751 to 4753," to transfer marijuana except pursuant to a written order form to be obtained by the transferee. A regulation, 26 CFR § 152.69, provides that the order form must show the name and address of the transferor and transferee; their § 4753 registration numbers, if they are registered; and the quantity of marijuana transferred. Another regulation, 26 CFR § 152.66, requires the transferee to submit an application containing these data in order to obtain the form. Section 4742(d) of the Act requires the International Revenue Service to "preserve" in its records a duplicate copy of each order form which it issues.

Another statutory provision, 26 U.S.C. § 4773, assures that the information contained in the order form will be available to law enforcement officials. That section provides that the duplicate order forms required to be kept by the Internal Revenue Service shall be open to inspection by Treasury personnel and state and local officials charged with enforcement of marijuana laws, and that upon payment of a fee such officials shall be furnished copies of the forms.[11]

Finally, 26 U.S.C. § 4744(a) makes it unlawful for a transferee required to pay the § 4741(a) transfer tax either to acquire marijuana without having paid the tax or to transport, conceal, or facilitate the transportation or concealment of, any marijuana so acquired.[12] Petitioner was convicted under the latter subsection. He conceded at trial that he had not obtained an order form or paid the transfer tax.

C.

If read according to its terms, the Marijuana Tax Act compelled petitioner to expose himself to a "real and appreciable" risk of self-incrimination, within the meaning of our decisions in *Marchetti, Grosso,* and *Haynes.* Sections 4741–4742 required him, in the course of obtaining an order form, to identify himself not only as a transferee of marijuana but as a transferee who had not registered and paid the occupational tax under §§ 4751–4753. Section 4773 directed that this information be conveyed by the Internal Revenue Service to state and local law enforcement officials on request.

Petitioner had ample reason to fear that transmittal to such officials of the fact that he was a recent, unregistered transferee of marijuana "would surely prove a significant 'link in a chain' of evidence tending to establish his guilt" [13] under the state marijuana laws then in effect.[14] When petitioner failed to comply with the Act, in late 1965, possession of any quantity of marijuana was apparently a crime in every one of the 50 States, including New York, where petitioner claimed the transfer occurred, and Texas, where he was arrested and convicted.[15]

[9] The transferor is secondarily liable for the tax. See 26 U.S.C. § 4741(b).

[10] The exceptions include transfers by or under prescription of a medical practitioner; legal exportation to foreign countries; transfers to government officials; and transfers of marijuana seeds to persons registered under § 4753.

[11] 26 U.S.C. § 6107, which requires that a list of "persons who have paid special taxes" under subtitles D and E of the Internal Revenue Code be kept for public inspection in each principal internal revenue office and that the list be furnished to state and local prosecutors on request, apparently does not apply to payors of transfer taxes. See *Haynes* v. *United States,* 390 U.S. 85, 99–100 (1968) [Ct. D. 1920, C.B. 1968–1, 615].

[12] The relevant text of § 4744(a) is set out in n. 3, *supra.*

[13] *Marchetti* v. *United States,* 390 U.S. 39, 48 (1968) [Ct. D. 1919, C.B. 1968–1 500].

[14] It is also possible that compliance with the Act also would have created a substantial risk of incrimination under 21 U.S.C. § 176a, the other federal statute which petitioner was convicted of violating (the relevant text of § 176a is reproduced in n. 1., *supra*). However, the danger of incrimination under state law is so plain that this possibility need not be explored further.

[15] At the time petitioner failed to comply with the Act, 48 States and the District of Columbia had on their books in some form essentially the provisions of the Uniform Narcotic Drug Act. See 9B Uniform Laws Ann. 409–410 (1966). Section 2 of that Act states: "It shall be unlawful for any person to * * * possess * * * any narcotic drug except as authorized in this act." Section 1(14) defines "narcotic drugs" to include marijuana ("cannabis"). The remaining two States, California and Pennsylvania, also have statutes making it a crime to possess marijuana. See Cal. Code Ann. § 11530 (1961); 35 Pa. Stat. Ann. §§ 780–2(g), 780–4(q) (1961).

In 1965, New York and Texas had in effect statutory provisions substantially identical to the above sections of the Uniform Act. For New York, see N.Y. Public Health Law §§ 3301(21), 3305 (1954); for Texas, see Vernon's Texas Penal Code Ann., Art. 725b §§ 1(14), 2 (1961). In New York possession of any amount of marijuana was a misdemeanor punishable by up to a year's imprisonment. See N.Y. Penal Law § 1751–(a)(1) (1954). See also *id.,* § 1751(2) (1956). In Texas, such possession was a felony punishable by imprisonment for not less than two years and not more than life. See Vernon's Texas Penal Code Ann., Art. 725b, § 23(1) (1957).

It is true that almost all States, including New York and Texas, had exceptions making lawful, under specified conditions, possession of marijuana by: (1) state-licensed manufacturers and wholesalers; (2) apothecaries; (3) researchers; (4) physicians, dentists, veterinarians, and certain other medical personnel; (5) agents or employees of the foregoing persons or common carriers; (6) persons for whom the drug had been prescribed or to whom it had been given by an authorized medical person; and (7) certain public officials.[16] However, individuals in the first four of these classes are among those compelled to register and pay the occupational tax under §§ 4751–4753;[17] in consequence of having registered, they are required to pay only a $1 per ounce transfer tax under § 4741(a)(1). It is extremely unlikely that such persons will remain unregistered, for failure to register renders them liable not only to an additional $99 per ounce transfer tax but also to severe criminal penalties.[18] Persons in the last three classes mentioned above appear to be wholly exempt from the order form and transfer tax requirements.[19]

Thus, at the time petitioner failed to comply with the Act those persons who might legally possess marijuana under state law were virtually certain either to be registered under § 4753 or to be exempt from the order form requirement. It follows that the class of possessors who were both unregistered and obliged to obtain an order form constituted "a select group inherently suspect of criminal activities." Since compliance with the transfer tax provisions would have required petitioner unmistakeably to identify himself as a member of this "select" and "suspect" group, we can only decide that when read according to their terms these provisions created a "real and appreciable" hazard of incrimination.

D.

The Government, however, vigorously contends that when the Act is considered together with the accompanying regulations, and in light of existing administrative practice, its incriminatory aspect will be seen to vanish or shrink to less than constitutional proportions. The Government points first to regulations, 26 CFR §§ 152.22, 152.23, added in 1964, which provide that every applicant for registration under §§ 4751–4753 must show that he is legally qualified to deal in marijuana according to the laws of the jurisdiction in which he is operating, and that the district director shall not permit an applicant to register until the director is satisfied that this is true. The Government then cites two other regulations, relating to applications for order forms under § 4742. The first, 26 CFR § 152.67, provides that such applications "[g]enerally * * * shall be signed by the same person or persons signing the application for registration," but when this is impracticable "they may be signed by another person, provided a power of attorney authorizing such other person to sign the applications * * * has previously been filed * * *." The second regulation, 26 CFR § 152.68, states that upon receipt of an application the district director "shall" compare the signature on the application "with that appearing on the application for registration or in the power of attorney," and that "[u]nless the district director is satisfied that the application is authentic, it will not be honored."

The Government asserts that these regulations clearly signify that no person will be permitted to register unless his activities are permissible under the law of his jurisdiction, and that no one will be permitted to obtain an order form and prepay the transfer tax unless he has registered.[20] The result, the Government contends, is simply to prohibit nonregistrants like petitioner from dealing in marijuana at all. The Government further asserts that the administrative practice of the Internal Revenue Service and the Bureau of Narcotics has always been consistent with this interpretation, though it concedes that there apparently has never been an attempt by a nonregistrant to prepay the tax. The Government does admit uncertainty as to whether the fact of such an attempt would have been communicated to law enforcement officials; however, it points out that nothing in the statute or regulations appears to compel such disclosure.[21] The Government argues that the regulations and administrative practice effectively refute the existence of a substantial hazard of incrimination at the time petitioner acquired marijuana: first, because a nonregistrant would have known that he could not obtain an order form and consequently never would have applied; second, because there was no substantial risk that an unsuccessful application would have been brought to the attention of law enforcement officials.

We cannot accept the Government's argument, for we find that Congress did intend that a nonregistrant should be able to obtain an order form and

[16] See, *e.g.*, Uniform Narcotic Drug Act §§ 3–11, 9B Uniform Laws Ann. 472–496 (1966); N.Y. Public Health Law §§ 3310, 3320–3333 (1966); Vernon's Texas Penal Code Ann., Art. 725b, §§ 5–12 (1961).

[17] See 26 U.S.C. §§ 4753 (1)–(6).

[18] See 26 U.S.C. §§ 4755(a)(1), 4755(a)(3), 7237(a).

[19] 26 U.S.C. §§ 4742(b)(1)–(2) exempt persons who receive marijuana under medical prescription or directly from a medical practitioner. Title 26 U.S.C. § 4742(b)(4) exempts transfers to public officials. And the design of the Act strongly suggests that a delivery of marijuana to an employee or agent of a registrant is considered a "transfer" to the registrant himself, see 26 U.S.C. § 4755(b)(3), 26 CFR §§ 152.41, 152.42, and that delivery to a common carrier is considered a "transfer" to the addressee. See 26 U.S.C. § 4755(b)(2), 26 CFR § 152.127(c).

[20] The Government argues that the $100 per ounce tax was intended to be collected only *civilly*, from those found to have engaged in illegal transfers. See Brief for the United States 19 nn. 23, 29. See also *United States* v. *Sanchez*, 340 U.S. 42 (1951) [Ct. D. 1735, C.B. 1950–2 139].

[21] After our decisions in *Marchetti*, *Grosso*, and *Haynes*, district directors were instructed that such applications should not be disclosed but simply returned to the applicant. See Brief for the United States 17, n. 16.

prepay the transfer tax. This congressional intent appears both from the language of the Act and from its legislative history.

We begin with the words of the statute. Section 4741(a), when read in conjunction with § 4742, imposes a tax upon every transfer of marijuana, with a few exceptions not here relevant.[22] Section 4741(a)(1) states that the tax on registrants shall be $1 per ounce and § 4741(a)(2) that the tax on transfers to nonregistrants shall be $100 per ounce. Section 4741(b) states that "[*s*]*uch tax shall be paid by the transferee at the time of securing each order form,* and shall be in addition to the price of such form." (Emphasis added.) Since § 4742(b) makes no distinction between the § 4741(a)(1) tax on transfers to registrants and the § 4741(a)(2) tax on transfers to nonregistrants, it seems clear that Congress contemplated that nonregistrant as well as registrant transferees should be able to obtain order forms and prepay the tax.

The legislative history also strongly indicates that the Act was intended merely to impose a very high tax on transfers to nonregistrants and not to prohibit such transfers entirely. As a taxing measure, the bill of course originated in the House of Representatives. At the start of the first hearing on the bill, before the House Ways and Means Committee, the committee chairman announced that he had introduced the bill at the request of the Secretary of the Treasury.[23] The transfer provisions of the bill then read essentially as they do now.[24] The first witness to appear before the Committee was the Treasury Department's Assistant General Counsel, Clinton M. Hester. He began by stating that the bill's purpose was "not only to raise revenue from the marijuana traffic, but also to discourage the current and widespread undesirable use of marijuana by smokers and drug addicts * * *." [25] He stated that in form the bill was a "synthesis" of the Harrison Narcotics Act, now 26 U.S.C. § 4701 *et seq.*, and the National Firearms Act, now 26 U.S.C. § 5841 *et seq.*[26] Both of these statutes compelled dealers in the respective goods to register and pay a special tax. Both prohibited transfer except in pursuance of a written form and imposed a transfer tax. However, the transfer provisions differed in that the Narcotics Act provided that no one except a registrant could legally obtain an order form, see 26 U.S.C. § 4705(g), while the Firearms Act merely imposed a $200 tax upon each transfer of a firearm covered by the Act.

The Treasury witness explained that the marijuana tax bill generally followed the plan of the Narcotics Act insofar as it required dealers in marijuana to register and prohibited transfers except by order form. But he testified that because of constitutional doubts:

"[a]t this point, this bill, like the National Firearms Act, departs from the plan of the Harrison Narcotics Act which limits the right to purchase narcotic drugs to persons who are permitted to register under that act.

* * * * *

"[I]n order to obviate the possibility of [an] attack upon the constitutionality of this bill, it, like the National Firearms Act, permits the transfer of marijuana to nonregistered persons upon the payment of a heavy transfer tax. The bill would permit the transfer of marijuana to anyone, but would impose a $100 per ounce tax upon a transfer to a person who might use it for purposes which are dangerous and harmful to the public * * *." [27]

Mr. Hester was also the first witness before the Senate Finance Committee. There he testified in less detail, stating at different points that the purpose of the transfer provisions was "to discourage the widespread use of the drug by smokers and drug addicts," [28] "to render extremely difficult the acquisition of marijuana by persons who desider it for illicit uses," [29] "to prevent transfers to persons who would use marijuana for undesirable purposes," [30] and "through the $100 transfer tax to prevent the drug from coming into the hands of those who would put it to illicit uses." [31]

The House and Senate reports describe the purposes of the transfer provisions largely in the language of Mr. Hester's testimony. The House report declares that the purpose was "to discourage the widespread use of the drug by smokers and drug addicts," [32] "to render extremely difficult the acquisition of marijuana by persons who desire it for illicit uses," [33] and "through the $100 transfer tax to prevent the drug from coming into the hands of those who will put it to illicit uses." [34] In discussing the issue of constitutionality, the report recites that "[t]he law is * * * settled that Congress has the power to enact a tax which is so heavy as to discourage the transactions or activities taxed" [35] and states that "[t]hese cases sustain the $100 tax imposed * * * upon transfers * * * to unregistered persons." [36] The Senate report, without discussing constitutionality, otherwise states the purpose of the transfer provisions in the very same words as the House report.[37] Thus, the committee reports confirm Mr. Hester's account of the bill's purposes. In

[22] See n. 10, *supra*.
[23] See Hearings on H.R. 6385 before the House Committee on Ways and Means, 75th Cong., 1st Sess., 5 (1937).
[24] See *id.*, at 3–5.
[25] *Id.*, at 7.
[26] *Ibid.*
[27] Hearings on H.R. 6385 before the House Committee on Ways and Means, 75th Cong., 1st Sess., 9 (1937). The doubts about the bill's constitutionality were occasioned by the dissenting opinions in *United States* v. *Doremus,* 249 U.S. 86, 95 (1919), and *Nigro* v. *United States,* 276 U.S. 332, 354, 357 (1928). See Hearings on H.R. 6385, *supra,* at 9.
[28] Hearings on H.R. 6906 before the Senate Committee on Finance, 75th Cong., 1st Sess., 5 (1937).
[29] *Id.*, at 6.
[30] *Id.*, at 6.
[31] *Id.*, at 7.
[32] H.R. Rep. No. 792, 75th Cong., 1st Sess., 1 (1937).
[33] *Id.*, at 2.
[34] *Id.*, at 2.
[35] *Id.*, at 3.
[36] *Id.*, at 3.
[37] See S. Rep. No. 900, 75th Cong., 1st Sess., 2–3 (1937).

short, the legislative history fully accords with the statutory language.

Upon this evidence, we have no hesitation in concluding that the interpretation which the Government would give to the transfer provisions is contrary to the manifest congressional intent that transfers to nonregistrants be taxed, not forbidden. Insofar as the regulations which require comparison of signatures necessarily compel the result urged by the Government, they must be regarded as contrary to the statute and hence beyond the scope of the regulation-making authority which was delegated by Congress.[38] It is true that these regulations were promulgated in 1937, and that Congress reenacted the entire Act in 1954, while they were in effect. However, the scanty legislative history accompanying that reenactment gives no hint that Congress knew of these particular regulations, much less of the indirect impact which the Government now ascribes to them.[39] As we recently noted in *Massachusetts Trustees* v. *United States,* 377 U.S. 235, 241, 242 (1964), congressional reenactment of the statute, even without any apparent knowledge of a particular regulation, can "strengthen to some extent" the regulation's claim to validity, but reenactment cannot save a regulation which "contradict[s] the requirement" of the statute itself. When a regulation conflicts with the statute, the fact of subsequent reenactment "is immaterial, for Congress could not add to or expand the statute by impliedly approving the regulation." *Commissioner* v. *Acker,* 361 U.S. 87, 93 (1959) [Ct. D. 1841, C.B. 1959–2, 491].[40]

Nor are we persuaded by the Government's argument that its construction has been followed by the Internal Revenue Service and the Bureau of Narcotics ever since the passage of the Act, and that this "long-standing" interpretation by the agencies charged with administering the Act should be controlling. We have often recognized that, as a general matter, a long-standing, contemporaneous construction of a statute by the administering agencies is "entitled to great weight," *FTC* v. *Mandel Bros.,* 359 U.S. 385, 391 (1959), and will be "show[n] great deference," *Udall* v. *Tallman,* 380 U.S. 1, 16 (1965).[41] However, in this instance the Government admits that until our decisions last Term in *Marchetti, Grosso,* and *Haynes,* the alleged interpretation had been made known only through the regulations themselves, since there apparently had never been an application by a nonregistrant to prepay the transfer tax. Morever, in its brief in this Court in *United States* v. *Sanchez,* 340 U.S. 42 (1951) [Ct. D. 1735, C.B. 1950–2, 139], the United States plainly took the position that the Act imposed only a tax and not a prohibition on transfers to nonregistrants,[42] implying that at that time the alleged administrative construction was unknown even to those charged with representing the United States in this Court. In these circumstances, the alleged administrative construction can furnish no additional support for the Government's argument.

The foregoing shows that at the time petitioner acquired marijuana he was confronted with a statute which on its face permitted him to acquire the drug legally, provided he paid the $100 per ounce transfer tax and gave incriminating information, and simultaneously with a system of regulations which, according to the Government, prohibited him from acquiring marijuana under any conditions. We have found those regulations so out of keeping with the statute as to be *ultra vires.* Faced with these conflicting commands, we think petitioner would have been justified in giving precedence to the higher authority: the statute.[43] " 'Literal and full compliance' with all the statutory requirements" [44] would have entailed a very substantial risk of self-incrimination. See *supra,* at 7–10.

The United States has not urged us, as it did in *Marchetti, Grosso,* and *Haynes,* to avoid this constitutional difficulty by placing restrictions upon the use of information gained under the transfer provisions. We declined to impose use restrictions in those cases because we found that the furnishing of information to interested prosecutors was a "significant element of Congress' purposes in adopting" the statute there involved. *Marchetti* v. *United States,* 390 U.S. 39, 59 (1968).[45] The text and legislative history of the Marijuana Tax Act plainly discloses a similar congressional purpose. As has been noted, 26 U.S.C. § 4773 requires that copies of order forms be kept available for inspection by state and local officials, and that copies be furnished to such officials on request. The House and Sen-

[38] The regulations, 26 CFR §§ 152.22, 152.23, see *supra,* at 10, which limit registration under § 4753 to persons whose marijuana dealings are legal under relevant state and local laws do not of themselves require the result urged by the Government. In fact, there is strong support in the legislative history for the proposition that illicit consumers of marijuana like petitioner are not entitled to register. The House and Senate reports and the testimony of Mr. Hester before the Senate Finance Committee all state, in identical language, that "[u]nder [the bill's] provisions, all legitimate handlers of marijuana are required to pay occupational taxes * * *." H.R. Rep. No. 792, 75th Cong., 1st Sess., 2 (1937); S. Rep. No. 900, 75th Cong., 1st Sess., 3 (1937); Hearings on H.R. 6906 before the Senate Committee on Finance, 75th Cong., 1st Sess., 6 (1937). In his testimony before the House Ways and Means Committee, Mr. Hester stated explicitly that "those who would consume marijuana are not eligible to register under the bill * * *." Hearings on H.R. 6385 before the House Committee on Ways and Means, 75th Cong., 1st Sess., 8 (1937).

[39] See H.R. Rep. No. 1337, 83d Cong., 2d Sess., A325 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess., 482–483 (1954).

[40] See also 1 K. Davis, Administrative Law § 5.07 (1958), and cases there cited.

[41] See generally *id.,* § 5.06.

[42] See Brief for the United States, *United States* v. *Sanchez,* 340 U.S. 42 (1951), at 28–29.

[43] Any other holding would give rise to additional knotty questions, such as whether petitioner's nonpayment of the transfer tax should be excused because of his actual or assumed reliance upon the erroneous administrative construction of the statute, under which he would not have been permitted to pay. Cf. *James* v. *United States,* 366 U.S. 213 (1961) [Ct. D. 1863, C.B. 1961–2, 9].

[44] *Grosso* v. *United States,* 390 U.S. 62, 65 (1968), quoting from *Albertson* v. *SACB,* 382 U.S. 70, 78 (1965).

[45] See also *Grosso* v. *United States, supra,* at 69; *Haynes* v. *United States,* 390 U.S. 85, 99–100 (1968).

ate reports both state that one objective of the Act was "the development of an adequate means of publicizing dealings in marijuana in order to tax and control the traffic effectively." [46] In short, we think the conclusion inescapable that the statute was aimed at bringing to light transgressions of the marijuana laws. Hence, as in last Term's cases, we decline to impose use restrictions and are obliged to conclude that a timely and proper assertion of the privilege should have provided a complete defense to prosecution under § 4744(a)(2).

E.

There remain the further questions whether this petitioner's claim of the privilege was timely and whether it was waived. As for timeliness, petitioner did not assert the privilege as a defense to the § 4744(a) count until his motion for a new trial. The Court of Appeals evidently regarded the claim as timely, for it rejected it on the merits both in its original opinion and in its denial of rehearing. See 383 F. 2d, at 870; 392 F. 2d, at 221–222. The Government does not contend that the claim of the privilege was untimely. Petitioner's trial occurred before our decisions in *Marchetti, Grosso,* and *Haynes,* and the Court of Appeals for the Fifth Circuit had recently rejected an identical self-incrimination claim. See *Haynes* v. *United States,* 339 F. 2d 30 (1964). Although it would have been preferable for petitioner to have asserted the privilege at trial, we hold that in the circumstances of this case his failure to raise the issue at that time did not amount to a waiver of the privilege. See *Grosso* v. *United States,* 390 U.S. 62, 70–71 (1968) [Ct. D. 1918, C.B. 1968–1,495].

In denying Leary's petition for rehearing, the Court of Appeals, in addition to holding the privilege generally inapplicable to prosecutions under § 4744(a), found that petitioner's claim of the privilege was improper because he "took the stand and affirmatively waived the privilege * * * by testifying fully to the details of his acquisition and transportation of marijuana without having paid the tax * * *." 392 F. 2d, at 222. In relying for that proposition on the statement in *Marchetti* that our decision in that case would not provide a shield for any taxpayer who was "outside the privilege's protection," 390 U.S., at 61, we think the Court of Appeals misconceived the thrust of that dictum. The aspect of the self-incrimination privilege which was involved in *Marchetti,* and which petitioner asserts here, is not the undoubted right of an accused to remain silent at trial. It is instead the right not to be criminally liable for one's previous failure to obey a statute which required an incriminatory act. Thus, petitioner is not asserting that he had a right to stand mute at his trial but that he cannot be convicted for having failed to comply with the transfer provisions of the Act at the time he acquired marijuana in 1965. His admission at trial that he had indeed failed to comply with the statute was perfectly consistent with the claim that that omission was excused by the privilege. Hence it could not amount to a waiver of that claim.

The Government suggests that petitioner waived his right to plead self-incrimination in yet another way, by testifying at trial that he had violated the statute for reasons entirely unrelated to fear of self-incrimination. It is true that some portions of petitioner's testimony indicate that his noncompliance was motivated, at least in part, by his conviction that the Act imposed an illegal tax upon religion or upon the "pursuit of knowledge" [47] and by his belief that, in consequence of the system of regulations and administrative practice described above, he would not be permitted to pay the tax.[48] However, other parts of petitioner's testimony clearly indicate that he also was influenced by an apprehension that by trying to pay the tax he might incriminate himself.[49] We cannot say that petitioner's testimony, taken as a whole, amounted to a waiver of the privilege. We conclude that petitioner's invocation of the privilege was proper and that it should have provided a full defense to the third count of the indictment. Accordingly, we reverse petitioner's conviction under 26 U.S.C. § 4744(a)(2).

II.

Next, we consider whether, in the circumstances of this case, the application of the presumption contained in 21 U.S.C. § 176a denied petitioner due process of law.

A.

Insofar as here relevant, § 176a imposes criminal punishment upon every person who:

"knowingly, with intent to defraud the United States, imports or brings into the United States marijuana contrary

[46] H.R. Rep. No. 792, 75th Cong., 1st Sess., 2 (1937); S. Rep. No. 900, 75th Cong., 1st Sess., 3 (1937).

[47] See Joint Appendix 87a–88a, 89a.

[48] See Joint Appendix 86a–89a. Of course, a holding that petitioner waived his right to plead self-incrimination by his reliance on the erroneous administrative interpretation would require consideration of the further question mentioned in n. 43, *supra:* whether such reliance should provide a defense.

[49] When first asked on direct examination why he had not paid the transfer tax, petitioner stated: "Well, I knew that I couldn't get such a permission * * *. I also know that if I had applied for such a [transfer tax] stamp I would probably subject myself to investigation * * *." Joint Appendix 86a. In response to a similar subsequent question, petitioner said: "I was very certain that I would not be able to pay the tax on the marijuana and that not only would it be taken away from me but I would be subjected to action." Joint Appendix 87a. And when asked whether he had "an honest belief that you could not obtain [an order form]," petitioner replied: "I had a strong and honest belief that I could not get it and it would just cause a lot of publicity and trouble for both the government and myself. And I am not trying to cause trouble * * *." Joint Appendix 89a.

to law * * *, or receives, conceals, buys, sells, or in any manner facilitates the transportation, concealment, or sale of such marijuana after being imported or brought in, knowing the same to have been imported or brought into the United States contrary to law * * *."

A subsequent paragraph establishes the presumption now under scrutiny:

"Whenever on trial for a violation of this subsection, the defendant is shown to have or to have had the marijuana in his possession, such possession shall be deemed sufficient evidence to authorize conviction unless the defendant explains his possession to the satisfaction of the jury."

The second count of the indictment charged petitioner with having violated the "transportation" and "concealment" provisions of § 176a.[50] Petitioner admitted at trial that he had acquired marijuana in New York; had driven with it to Laredo, Texas; had continued across the bridge to the Mexican customs station; and then had returned to the United States. He further testified that he did not know where the marijuana he acquired had been grown.[51]

In view of this testimony, the trial court instructed the jury that it might find petitioner guilty of violating § 176a on either of two alternative theories. Under the first or "South-North" theory, a conviction could have been based solely upon petitioner's own testimony that the marijuana had been brought back from Mexico into the United States and that with knowledge of that fact petitioner had continued to transport it. Under the second or "North-South" theory, the conviction would have depended partly upon petitioner's testimony that he had transported the marijuana from New York to Texas and partly upon the challenged presumption.[52]

The Government contends that by giving testimony at trial which established all elements of the offense under the "South-North" theory, and by failing to object to the jury instructions on the ground now advanced, petitioner foreclosed himself from raising the point thereafter. We cannot agree. Even assuming that petitioner's testimony did supply all the evidence required for a valid conviction under the "South-North" theory, the jury nevertheless was told that it could alternatively convict with the aid of the presumption under the "North-South" theory. For all we know, the conviction did rest on that ground. It has long been settled that when a case is submitted to the jury on alternative theories the unconstitutionality of any of the theories requires that the conviction be set aside. See, *e.g.*, *Stromberg* v. *California*, 283 U.S. 359 (1931).

It is true that petitioner did not object to the jury instructions on the basis of the presumption's alleged unconstitutionality.[53] However, he did rely upon that ground in his previous motion for a directed verdict at the close of the prosecution's case, and urged it again in his subsequent motion for a new trial.[54] Both motions were denied. The Court of Appeals considered petitioner's constitutional argument on the merits, and rejected it. See 383 F. 2d, at 868–870. In these circumstances, we conclude that the question is properly before us.[55]

B.

By what criteria is the constitutionality of the § 176a presumption to be judged?

Early decisions of this Court set forth a number of different standards by which to measure the validity of statutory presumptions.[56] However, in *Tot* v. *United States*, 319 U.S. 463 (1943), the Court singled out one of these tests as controlling, and the *Tot* rule has been adhered to in the two subsequent cases in which the issue has been presented. The *Tot* Court had before it a federal statute[57] which, as construed, made it a crime for one previously convicted of a crime of violence to receive any firearm or ammunition in an interstate transaction. The statute further provided that "the possession of a firearm or ammunition by any such person shall be presumptive evidence that such firearm or ammuni-

[50] As has been noted, the first count charged him with smuggling in violation of § 176a, but the District Court dismissed that count. See *supra*, at 3 and n. 4.

[51] See Joint Appendix 90a.

[52] With respect to this theory, the trial judge stated near the end of his charge to the jury:

"Now, you might have some difficulty with the question on Count 2 * * *.

"I mention this a second time because you might be confused about the question of importation.

"We are not talking necessarily about the importation or what the government contends was importation here at the bridge.

"The defendant has told us that he received the marijuana in New York. This statute, of course, is of application throughout the land and the presumption would still apply that the narcotic had been imported illegally unless he explains his possession to the satisfaction of the jury." Joint Appendix 103a–104a.

[53] See 2 Transcript of Record 612–614.

[54] See 1 Transcript of Record 198–200; 2 Transcript of Record, 492, 649.

[55] We think it irrelevant that petitioner himself testified at trial that he had no knowledge of the marijuana's origin. The Government put in no affirmative evidence of knowledge, and the jury was instructed that it could convict under the "North-South" theory, relying upon the §176a presumption to permit an inference of knowledge. The trial judge did not mention petitioner's testimony on this point in his instructions to the jury. Since the presumption is by its terms rebuttable, the intended implication must have been that the jury could convict on the basis of the presumption only if it disbelieved the testimony. Cf. *Caudillo* v. *United States*, 253 F. 2d 513, 518 (1958).

[56] One test was whether there was a "rational connection" between the basic fact and the presumed fact. See *Mobile, J. & K. C. R. Co.* v. *Turnipseed*, 219 U.S. 35 (1910); *McFarland* v. *American Sugar Rfg. Co.*, 241 U.S. 79 (1916); *Western & Atl. R. Co.* v. *Henderson*, 279 U.S. 639 (1929); cf. *Yee Hem* v. *United States*, 268 U.S. 178 (1925). A second was whether the legislature might have made it a crime to do the thing from which the presumption authorized an inference. See *Ferry* v. *Ramsey*, 277 U.S. 88 (1928). A third was whether it would be more convenient for the defendant or for the prosecution to adduce evidence of the presumed fact. See *Morrison* v. *California*, 291 U.S. 82 (1934); cf. *Rossi* v. *United States*, 289 U.S. 89 (1933); *Yee Hem* v. *United States*, *supra*.

[57] Section 2(f) of the Federal Firearms Act, 52 Stat. 1250, 15 U.S.C. § 902(f).

tion was shipped or transported or received, as the case may be, by such person in violation of this Act."

The Court, relying upon a prior decision in a civil case,[58] held that the "controlling" test for determining the validity of a statutory presumption was "that there be a rational connection between the facts proved and the fact presumed." 319 U.S., at 467. The Court stated:

"Under our decisions, a statutory presumption cannot be sustained if there be no rational connection between the fact proved and the ultimate fact presumed, if the inference of the one from the proof of the other is arbitrary because of lack of connection between the two in common experience. This is not to say that a valid presumption may not be rested upon a view of relation broader than a jury might take in a specific case. But where the inference is so strained as not to have a reasonable relation to the circumstances of life as we know them, it is not competent for the legislature to create it as a rule governing the procedure of courts." 319 U.S., at 467–468 (footnotes omitted).

The *Tot* Court reduced to the status of a "corollary" another test which had some support in prior decisions:[59] whether it was more convenient for the defendant or for the Government to supply proof of the ultimate fact which the presumption permitted to be inferred. The Court stated that "[t]he argument from convenience is admissible only where the inference is a permissible one * * *." 319 U.S., at 469. The Court rejected entirely another suggested test with some backing in the case law,[60] according to which the presumption should be sustained if Congress might legitimately have made it a crime to commit the basic act from which the presumption allowed an inference to be drawn.[61] The *Tot* Court stated simply that "for whatever reason" Congress had not chosen to make the basic act a crime. *Id.*, at 472.

Applying the "rational connection" test, the Court held the *Tot* presumption unconstitutional. The Court rejected the contention that because most States forbade intrastate acquisition of firearms without a record of the transaction or registration of ownership it could be inferred merely from possession that an acquisition which did not meet these requirements must have been interstate, noting the alternative possibilities of unlawful intrastate acquisition and interstate shipment prior to the beginning of state regulation. See *id.*, at 468.[62]

The two subsequent cases in which this Court ruled upon the constitutionality of criminal statutory presumptions, *United States* v. *Gainey*, 380 U.S. 63 (1965) [Ct. D. 1901, C.B. 1965–2, 523], and *United States* v. *Romano*, 382 U.S. 136 (1965) [Ct. D. 1911, C.B. 1966–2, 546], involved companion sections of the Internal Revenue Code dealing with illegal stills. The presumption in *Gainey* was worded similarly to the one at issue here; it permitted a jury to infer from a defendant's presence at an illegal still that he was "carrying on" the business of a distiller "unless the defendant explains such presence to the satisfaction of the jury * * * ." See 26 U.S.C. §§ 5601(a)(4), 5601(b)(2).

We held that the *Gainey* presumption should be tested by the "rational connection" standard announced in *Tot*. We added:

"The process of making the determination of rationality is, by its nature, highly empirical, and in matters not within specialized judicial competence or completely commonplace, significant weight should be accorded the capacity of Congress to amass the stuff of actual experience and cull conclusions from it." 380 U.S., at 67.

Applying these principles, we sustained the *Gainey* presumption, finding that it "did no more than 'accord to the evidence, if unexplained, its natural probative force.' " 380 U.S., at 71.

The presumption under attack in *United States* v. *Romano, supra,* was identical to that in *Gainey* except that it authorized the jury to infer from the defendant's presence at an illegal still that he had possession, custody, or control of the still. See 26 U.S.C. §§ 5601(a)(1), 5601(b)(1). We held this presumption invalid. While stating that the result in *Gainey* was entirely justified because "[p]resence at an operating still is sufficient evidence to prove the charge of 'carrying on' because anyone present is very probably connected with the illegal enterprise," 382 U.S., at 141, we concluded:

"Presence is relevant and admissible evidence in a trial on a possession charge; but absent some showing of the defendant's function at the still, its connection with possession is too tenuous to permit a reasonable inference of guilt—'the inference of the one from proof of the other is arbitrary * * *.' " *Tot* v. *United States,* 319 U.S. 463, 467. *Ibid.*[63]

The upshot of *Tot, Gainey,* and *Romano* is, we think, that a criminal statutory presumption must be regarded as "irrational" or "arbitrary," and hence unconstitutional, unless it can at least be said with substantial assurance that the presumed fact is more likely than not to flow from the proved fact

[58] *Mobile, J. & K. C. R. Co.* v. *Turnipseed,* 219 U.S. 35 (1910).

[59] See n. 56, *supra.*

[60] See *ibid.*

[61] For example, it was argued in *Tot* that in order to regulate interstate commerce in firearms Congress might have prohibited possession of *all* firearms by persons who had been convicted of crimes of violence.

[62] The Court declared that there was even less reason to conclude from possession that the acquisition had occurred subsequent to the effective date of the Firearms Act.

[63] Like the Court in *Tot,* we limited ourselves in *Romano* to consideration of the crime Congress actually had defined. We observed that Congress had not chosen to make presence at an illegal still a crime in itself, but had only "declar[ed] presence to be sufficient evidence to prove the crime of possession beyond a reasonable doubt," and concluded that "[t]his approach obviously fails under the standards traditionally applied to such legislation." 382 U.S., at 144.

on which it is made to depend.[64] And in the judicial assessment the congressional determination favoring the particular presumption must, of course, weigh heavily.

C.

How does the § 176a presumption fare under these standards?

So far as here relevant, the presumption, quoted *supra,* at 223, authorizes the jury to infer from a defendant's possession of marijuana two necessary elements of the crime: (1) that the marijuana was imported or brought into the United States illegally; and (2) that the defendant knew of the unlawful importation or bringing in.[65] Petitioner argues that neither inference is valid, citing undisputed testimony at his trial to the effect that marijuana will grow anywhere in the United States, and that some actually is grown here.[66] The Government contends, on the other hand, that both inferences are permissible. For reasons that follow, we hold unconstitutional that part of the presumption which relates to a defendant's knowledge of illegal importation. Consequently, we do not reach the question of the validity of the "illegal importation" inference.

With regard to the "knowledge" presumption, we believe that *Tot* and *Romano* require that we take the statute at face value and ask whether it permits conviction upon insufficient proof of "knowledge," rather than inquire whether Congress might have made possession itself a crime.[67] In order thus to determine the constitutionality of the "knowledge" inference, one must have direct or circumstantial data regarding the beliefs of marijuana users generally about the source of the drug they consume. Such information plainly is "not within specialized judicial competence or completely commonplace," *United States* v. *Gainey, supra,* at 224. Indeed, the presumption apparently was enacted to relieve the Government of the burden of having to adduce such evidence at every trial, and none was introduced by the prosecution at petitioner's trial. Since the determination of the presumption's constitutionality is "highly empirical," *ibid.*, it follows that we must canvass the available, pertinent data.

Of course, it must be kept in mind that "significant weight should be accorded the capacity of Congress to amass the stuff of actual experience and cull conclusions from it." *Ibid.* However, it quickly becomes apparent that the legislative record does not supply an adequate basis upon which to judge the soundness of the "knowledge" part of the presumption. We have therefore taken other materials into account as well, in an effort to sustain the presumption. In so doing, we have not confined ourselves to data available at the time the presumption was enacted in 1956, but have also considered more recent information, in order both to obtain a broader general background and to ascertain whether the intervening years have witnessed significant changes which might bear upon the presumption's validity.[68]

As has been noted, we do not decide whether the presumption of illegal importation is itself constitutional. However, in view of the paucity of direct evidence as to the beliefs of marijuana smokers generally about the source of their marijuana, we have found it desirable to survey data concerning the proportion of domestically consumed marijuana which is of foreign origin, since in the absence of better information the proportion of marijuana actually imported surely is relevant in deciding whether marijuana possessors "know" that their marijuana is imported.

D.

Since the importation question is a subsidiary one, we take it up first, beginning, of course, with the legislative history of § 176a. The House and Senate committee reports and the floor debates are relatively unhelpful.[69] More informative are the records of extensive hearings before House and Senate committees.[70] Near the outset of the Senate committee hearings, the then Commissioner of Narcotics, Harry J. Anslinger, estimated that 90% of all marijuana seized by federal authorities had been smuggled from Mexico, and that "although there is considerable volunteer growth from old plantings in the Middle West * * *, [t]here is very little of the local land used because it just does not have the advantage of the long summer growing and [domestic marijuana] is not as potent as the

[64] Since we find that the § 176a presumption is unconstitutional under this standard, we need not reach the question whether a criminal presumption which passes muster when so judged must also satisfy the criminal "reasonable doubt" standard if proof of the crime charged or an essential element thereof depends upon its use. Cf. *United States* v. *Adams,* 293 F. Supp. 776, 783–784 (1968). See also *United States* v. *Romano, supra,* at 140–144; Note, The Constitutionality of Statutory Criminal Presumptions, 34 U. Chi. L. Rev. 141 (1966).

[65] The presumption also permits inference of a third element: that the importation or bringing in was with intent to defraud the United States. The permissibility of this inference was not one of the questions presented in Leary's petition for certiorari, and on the view we take of this branch of the case we have no occasion to consider it.

[66] See 1 Transcript of Record 165, 186–187. Petitioner attempted to introduce further evidence concerning the proportion of domestically consumed marijuana which in fact has been grown in the United States, but the District Court held it irrelevant and therefore inadmissible. See 2 Transcript of Record 517.

[67] See *supra,* at 26 and n. 63.

[68] A statute based upon a legislative declaration of facts is subject to constitutional attack on the ground that the facts no longer exist; in ruling upon such a challenge a court must, of course, be free to reexamine the factual declaration. See *Block* v. *Hirsh,* 256 U.S. 135, 154–155 (1921); *Communist Party* v. *SACB,* 367 U.S. 1, 110–114 (1961).

[69] See S. Rep. No. 1197, 84th Cong., 2d Sess., 7, 13 (1956); H.R. Rep. No. 2388, 84th Cong., 2d Sess., 3, 6 (1956); H.R. Rep. No. 2546, 84th Cong., 2d Sess., 14 (1956) (conference report); 102 Cong. Rec. 269, 271, 9015, 10688, 12166.

[70] Hearings on Traffic in Narcotics before a Subcommittee of the House Committee on Ways and Means, 84th Cong., 1st Sess. (1955) (hereinafter cited as House Hearings); Hearings on Illicit Narcotics Traffic before the Subcommittee on Improvements in the Federal Criminal Code of the Senate Committee on the Judiciary, 84th Cong., 1st Sess. (1955) (hereinafter cited as Senate Hearings).

Mexican drug." [71] A number of officials responsible for enforcing the narcotics laws in various localities estimated that a similar proportion of the marijuana consumed in their areas was of Mexican origin.[72]

On the other hand, written material inserted in the record of the Senate hearings included former testimony of an experienced federal customs agent before another Senate committee, to the effect that high-quality marijuana was being grown near the Texas cities of Laredo and Brownsville.[73] A written report of the Ohio Attorney General recited that marijuana "may grow unnoticed along roadsides and vacant lots in many parts of the country," [74] and a Philadelphia Police Academy bulletin stated that "Plenty of [marijuana] is found growing in the city." [75]

Examination of periodicals and books published since the enactment of the presumption leaves no doubt that in more than a dozen intervening years there have been great changes in the amount and nature of marijuana use in this country. With respect to quantity, one readily available statistic is indicative: the amount of marijuana seized in this country by federal authorities has jumped from about 3,400 pounds in 1956 to about 61,400 pounds in 1967.[76] With regard to nature of use, the 1655 hearing records and other reports portray marijuana smoking as at that time an activity almost exclusively of unemployed or menially employed members of racial minorities.[77] Current periodicals and books, on the other hand, indicate that marijuana smoking has become common on many college campuses and among persons who have voluntarily "dropped out" of American society in protest against its values, and that marijuana smokers include a sizeable number of young professional persons.[78]

Despite these undoubted changes, the materials which we have examined point quite strongly to the conclusion that most domestically consumed marijuana is still of foreign origin. During the six years 1962–1967, some 79% of all marijuana seized by federal authorities was seized in attempted smuggling at ports and borders.[79] The Government informs us that a considerable part of the internally seized marijuana bore indications of foreign origin.[80] While it is possible that these facts reflect only the deployment of federal narcotics forces, rather than the actual proportion of imported to domestic marijuana, almost all of the authorities which we have consulted confirm that the preponderance of domestically consumed marijuana is grown in Mexico.[81]

Petitioner makes much of statistics showing the number of acres of domestic marijuana destroyed annually by state and federal authorities, pointing out that if harvested the destroyed acreage could in each year have accounted for all marijuana estimated to have been consumed in the United States,[82] and that no one knows how many acres escape destruction. However, several factors weaken this argument from domestic growth. First, the number of acres annually destroyed declined by a factor of three between 1959 and 1967,[83] while during the same period the consumption of marijuana, as measured by federal seizures, rose twenty-fold.[84] Assuming constant diligence on the part of those charged with destruction, this would indicate that in 1967 a much smaller share of the market was domestically supplied than in 1959. Second, while the total number of acres annually destroyed has indeed been large enough to furnish all domestically consumed marijuana,[85] the state-by-state breakdowns which are available for the years 1964–1967 reveal that in each of those years more than 95% of the destroyed acreage was in two midwestern states, Illinois and

[71] Senate Hearings 18.

[72] See House Hearings 618, 1071; Senate Hearings 2384, 2471–2472, 4370, 4630. See also House Hearings 889; Senate Hearings 2893, 3488–3490; 102 Cong. Rec. 269, 271.

[73] See Senate Hearings 3488–3489.

[74] *Id.*, at 8414.

[75] *Id.*, at 599. See also Senate Hearings 4167.

[76] Compare Bureau of Narcotics, Report on the Traffic in Opium and Other Dangerous Drugs 66 (1956), with *id.*, at 43 (1967). These seizures are estimated to represent 10% of the marijuana actually smuggled into the United States. See Joint Appendix 92a.

[77] See, *e.g.*, J. Rosevear, Pot: A Handbook of Marijuana 118 (1967); Bouquet: Cannabis, Parts III–V, 3 Bull. on Narcotics, No. 1, at 32–33 (1951); Mayor's Committee on Marijuana, The Marijuana Problem in the City of New York 17–25 (1944); Blum, Mind-Altering Drugs and Dangerous Behavior: Dangerous Drugs 24, in President's Commission on Law Enforcement and the Administration of Justice, Task Force Report: Narcotics and Drug Abuse (1967).

[78] See, *e.g.*, J. Rosevear, *supra*, at 117–132 (1967); Bureau of Narcotics, Report on the Traffic in Opium and Other Dangerous Drugs 2, 40 (1966); Blum, *supra*, at 24; Cahn, The User and the Law, in J. Simmons (ed.), Marijuana: Myths and Realities (1967); McGlothlin, Toward a Rational View of Marijuana 195–198, in J. Simmons (ed.), *supra*.

[79] See Bureau of Narcotics, Report of the Traffic in Opium and Other Dangerous Drugs 66 (1962); *id.*, at 28 (1963); *id.*, at 84 (1964); *id.*, at 51 (1965); *id.*, at 45 (1966); *id.*, at 43 (1967).

[80] See Brief for the United States 40.

[81] See, *e.g.*, Bureau of Narcotics, Report on the Traffic in Opium and Other Dangerous Drugs 36 (1963); *id.*, at 30 (1964); Mandel, Myths and Realities of Marijuana Pushing 58–110, in J. Simmons (ed.), Marijuana: Myths and Realities (1967); President's Commission on Law Enforcement and the Administration of Justice, Report: The Challenge of Crime in a Free Society 213 (1967); J. Simmons (ed.), *supra*, at 233; United States Government, Report on the Working of the International Treaties on Narcotic Drugs 17 (1966); *id.*, at 24–25 (1967). Contra, see 1 Transcript of Pretrial Hearing, *United States* v. *Adams*, 293 F. Supp. 776 (1968), at 67, 76 (testimony of Dr. Richard Schultes, Director of Harvard Botanic Museum). See also J. Rosevear, Pot: A Handbook of Marijuana 35, 119–120 (1967).

[82] In 1967, 1,466 acres were destroyed. See United States Government, Report on the Working of the International Treaties on Narcotic Drugs 30 (1967). Accepting the Bureau of Narcotics' lowest estimate of yield per acre, see Brief for the United States 38, n. 42, this acreage would have supplied over 1,200,000 pounds of marijuana. This is enough for about 18,000,000,000 marijuana cigarettes. See *infra*, at 43 and n. 109.

[83] Compare Bureau of Narcotics, Report on the Traffic in Opium and Other Dangerous Drugs 12 (1959), with United States Government, Report on the Working of the International Treaties on Narcotic Drugs 9 (1967). The decline was steady.

[84] Compare Bureau of Narcotics, Report on the Traffic in Opium and Other Dangerous Drugs 43 (1959), with *id.*, at 43 (1967).

[85] See n. 82, *supra*.

Minnesota.[86] The large, recurrent marijuana acreages discovered in those States can plausibly be ascribed to the "volunteer growth from old plantings in the Middle West" about which Commissioner Anslinger testified,[87] while illicit cultivators of marijuana would be likely to choose States with sparser populations and more favorable climates.[88] Third and last, reports of the Bureau of Narcotics and testimony of its agents indicate that in its far-reaching investigations the Bureau has never encountered a system for distributing sizeable quantities of domestically grown marijuana.[89] In contrast the Bureau has found evidence of many large-scale distribution systems with sources in Mexico.[90]

E.

The Government urges that once it is concluded that most domestically consumed marijuana comes from abroad—a conclusion which we think is warranted by the data just examined—we must uphold the "knowledge" part of the presumption in light of this Court's decision in *Yee Hem* v. *United States,* 268 U.S. 178 (1925). In that case, the Court sustained a presumption which was virtually identical to the one at issue here except that the forbidden substance was smoking opium rather than marijuana. With respect to the inference of knowledge from possession which was authorized by that presumption, the Court said:

"Legitimate possession [of opium], unless for medical use, is so highly improbable that to say to any person who obtains the outlawed commodity, 'since you are bound to know that it cannot be brought into this country at all, except under regulation for medical use, you must at your peril ascertain and be prepared to show the facts and circumstances which rebut, or tend to rebut, the natural inference of unlawful importation, or your knowledge of it,' is not such an unreasonable requirement as to cause it to fall outside the constitutional power of Congress." 268 U.S., at 184.

The Government contends that *Yee Hem* requires us to read the § 176a presumption as intended to put every marijuana smoker on notice that he must be prepared to show that any marijuana in his possession was not illegally imported, and that since the possessor is the person most likely to know the marijuana's origin it is not unfair to require him to adduce evidence on that point. However, we consider that this approach, which closely resembles the test of comparative convenience in the production of evidence,[91] was implicitly abandoned in *Tot* v. *United States.* As was noted previously, the *Tot* Court confronted a presumption which allowed a jury to infer from possession of a firearm that it was received in interstate commerce. Despite evidence that most States prohibited unregistered and unrecorded acquisition of firearms, the Court did not read the statute as notifying possessors that they must be prepared to show that they received their weapons in intrastate transactions, as *Yee Hem* would seem to dictate. Instead, while recognizing that "the defendants * * * know better than anyone else whether they acquired the firearms in commerce," 319 U.S., at 469, the Court held that because of the danger of overreaching it was incumbent upon the prosecution to demonstrate that the inference was permissible before the burden of coming forward could be placed upon the defendant. This was a matter which the *Yee Hem* Court either thought it unnecessary to consider or assumed when it described the inference as "natural." [92]

F.

We therefore must consider in detail whether the available evidence supports the conclusion that the "knowledge" part of the § 176a presumption is constitutional under the standard established in *Tot* and adhered to in *Gainey* and *Romano*—that is, whether it can be said with substantial assurance that one in possession of marijuana is more likely than not to know that his marijuana was illegally imported.

Even if we assume that the previously assembled data are sufficient to justify the inference of illegal importation, see *supra,* at 36, it by no means follows that a majority of marijuana possessors "know" [93] that their mari-

[86] See Bureau of Narcotics, Report on the Traffic in Opium and Other Dangerous Drugs 17 (1965); United States Government, Report on the Working of the International Treaties on Narcotic Drugs 10 (1966); *id.,* at 9 (1967).

[87] See *supra,* at 31.

[88] Most authorities believe that more potent marijuana can be grown in a hot, dry climate. See *infra,* at 41 and n. 102.

[89] See Bureau of Narcotics, Reports on the Traffic in Opium and Other Dangerous Drugs 1956–1967; 2 Transcript of Pretrial Hearing, *United States* v. *Adams,* 293 F. Supp. 776 (1968), at 37–45; United States Government, Report on the Working of the International Treaties on Narcotic Drugs 17 (1966); *id.,* at 24–25 (1967). But cf. Senate Hearings 3488–3490.

[90] See *e.g.,* Bureau of Narcotics, Report on the Traffic in Opium and Other Dangerous Drugs (1965), at 23 (seizure of about 1,800 pounds of Mexican marijuana), 23–24 (seizure of about one ton of Mexican marijuana), 24 (seizure of about 3½ tons of Mexican marijuana); *id.* (1966), at 17 (seizure of about 600 pounds of Mexican marijuana). By contrast, the largest reported seizure of marijuana definitely grown in the United States involved only about eight pounds. See *id.,* at 7 (1967). But see also Senate Hearings 3488–3490.

[91] See *supra,* at 25–26 and n. 56.

[92] In refusing to follow this aspect of the reasoning in *Yee Hem,* we intimate no opinion whatever about the continued validity of the presumption relating to "hard" narcotics, which was sustained in *Yee Hem* and is now found in 21 U.S.C. § 174. As will appear, our holding that the § 176a "knowledge" presumption is unconstitutional rests entirely upon a detailed inquiry into the available facts about the state of mind of marijuana users. The facts regarding "hard" narcotics may well be significantly different.

[93] Nothing in the legislative history of § 176a is of aid in determining the intended scope of the word "knowing," as it is used in that section. In making that determination, we have employed as a general guide the definition of "knowledge" which appears in the Proposed Official Draft of the Model Penal Code, at 27 (1962). The Code provides:

"When knowledge of a particular fact is an element of an offense, such knowledge is established if a person is aware of a high probability of its existence, unless he actually believes that it does not exist."

juana was illegally imported. Any such proposition would depend upon an intermediate premise: that most marijuana possessors are aware of the level of importation and have deduced that their own marijuana was grown abroad. This intermediate step might be thought justified by common sense if it were proved that little or no marijuana is grown in this country. Short of such a showing, not here present, we do not believe that the inference of knowledge can be sustained solely because of the assumed validity of the "importation" presumption.

Once it is established that a significant percentage of domestically consumed marijuana may not have been imported at all, then it can no longer be postulated, without proof, that possessors will be even roughly aware of the proportion actually imported. We conclude that in order to sustain the inference of knowledge we must find on the basis of the available materials that a majority of marijuana possessors either are cognizant of the apparently high rate of importation or otherwise have become aware that *their* marijuana was grown abroad.

We can imagine five ways in which a possessor might acquire such knowledge: (1) he might be aware of the proportion of domestically consumed marijuana which is smuggled from abroad and deduce that his was illegally imported; (2) he might have smuggled the marijuana himself; (3) he might have learned by indirect means that the marijuana consumed in his locality or furnished by his supplier was smuggled from abroad; (4) he might have specified foreign marijuana when making his "buy," or might have been told the source of the marijuana by his supplier; (5) he might be able to tell the source from the appearance, packaging, or taste of the marijuana itself.

We treat these five possibilities *seriatim,* in light of the available materials, beginning in each instance with the legislative record. We note at the outset that although we have been able to discover a good deal of relevant secondary evidence, we have found none of the best kind possible—testimony of marijuana users about their own beliefs as to origin, or studies based upon interviews in which users were asked about this matter. The committee hearings which preceded passage of § 176a included testimony by many marijuana smokers, but none was ever asked whether he knew the origin of the marijuana he smoked. It should also be kept in mind that the great preponderance of marijuana smokers are "occasional" rather than "regular" users of the drug,[94] and that "occasional" smokers appear to be arrested disproportionately often due to their inexpertness in taking precautions.[95] "Occasional" users are likely to be less informed and less particular about the drug they smoke;[96] hence, it is less probable that they will have learned its source in any of the above ways.

The first possibility is that a possessor may have known the proportion of imported to domestic marijuana and have deduced that his own marijuana was grown abroad. The legislative record is of no assistance in evaluating this possibility. Such indirect evidence as we have found points to the conclusion that while most marijuana users probably know that some marijuana comes from Mexico, it is also likely that the great majority either have no knowledge about the proportion which is imported or believe that the proportion is considerably lower than may actually be the case.[97]

The second possibility is that a possessor may know the origin of his marijuana because he smuggled it into the United States himself. The legislative record is unhelpful in estimating the proportion of possessors who fall into this class. Other sources indicate that there are a considerable number of smokers who "smuggle their own," but that the great majority of possessors have obtained their marijuana from suppliers in this country.[98]

The legislative record is also uninformative about the possibility that a possessor may have learned the source of his marijuana by indirect means. Other sources reveal that imported marijuana usually passes through a number of hands before reaching the consumer, and that the distribution system is kept secret.[99] It would appear that relatively few consumers know the origin of their marijuana by indirect means.

The fourth possibility is that the possessor may have specified foreign marijuana when making his purchase or may have been told by his supplier that the marijuana was grown abroad. The legislative record is somewhat more helpful with respect to this possibility, for it does contain statements to the effect that Mexican marijuana is more potent that domestic and is consequently preferred by smokers.[100] However, the legislative record also contains testimony by a customs agent that Texas marijuana is as "good" as that from Mexico.[101] Most authorities state that Mexican marijuana generally does have greater intoxicating power than domestic marijuana, due to the higher temperatures and lower humidity usually encountered in

[94] See J. Rosevear, Pot: A Handbook of Marijuana 124–125 (1967). It has been estimated that there are 500,000 to 1,000,000 "regular" marijuana smokers in the United States and 3,000,000 to 5,000,000 "occasional" users. See J. Simmons (ed.), Marijuana: Myths and Realities 232 (1967).

[95] See *id.*, at 236; J. Rosevear, *supra,* at 121–125.

[96] See *ibid.*

[97] See *United States* v. *Adams,* 293 F. Supp. 776, 780–781, 784–785 (1968).

[98] See Becker, Marijuana: A Sociological Overview 47–50, in D. Solomon (ed.), The Marijuana Papers (1966); Mandel, Myths and Realities of Marijuana Pushing 58–110, in J. Simmons (ed.), Marijuana: Myths and Realities (1967); J. Rosevear, Pot: A Handbook of Marijuana 27–37, 117–131 (1967); J. Simmons (ed.), *supra,* at 231–234. It should be remembered that there are estimated to be at least 3,500,000 "regular" or "occasional" marijuana smokers in the United States. See n. 94, *supra.*

[99] See authorities cited in n. 98, *supra.*

[100] See *supra,* at 31 (testimony of Commissioner Anslinger); House Hearings 1071–1072, Senate Hearings 4354–4355 (statements of District Supervisor Aman).

[101] See Senate Hearings 3488–3489. See also House Hearings 288.

Mexico.[102] There are some indications that smokers are likely to prefer Mexican marijuana,[103] but there is nothing to show that purchasers commonly specify Mexican marijuana when making a "buy." It appears that suppliers of marijuana occasionally volunteer the place of origin,[104] but we have found no hint that this is usually done, and there are indications that if the information is not volunteered the buyer may be reluctant to ask, for fear of being thought an informer.[105] We simply are unable to estimate with any accuracy, on the basis of these data, what proportion of marijuana possessors have learned the origin of their marijuana in this way. It is certainly not a majority; but whether it is a small minority or a large one we are unable to tell.

The fifth possibility is that a smoker may be able to tell the source of his marijuana from its appearance, packaging, or taste. As for appearance, it seems that there is only one species of marijuana, and that even experts are unable to tell by eye where a particular sample was grown.[106] The Court of Appeals for the Ninth Circuit did find in *Caudillo* v. *United States,* 253 F. 2d 513 (1958), on the basis of trial testimony, that "unmanicured" or "rough" marijuana—that is, marijuana containing some seeds and stems, as well as leaves—was much more likely to come from Mexico than from California; this was because the presence of seeds implied that the plant had been allowed to mature and evidence showed that California growers almost always harvested the plant before that stage. However, we have found nothing to indicate that this distinction holds good in other areas of the country, or that marijuana possessors are likely to realize its significance.

With respect to packaging, there is evidence that Mexican marijuana is commonly compressed into distinctive "bricks" and then wrapped in characteristically Mexican paper.[107] Yet even if it is assumed that most Mexican marijuana bears such distinguishing marks when first brought into this country, there is no indication that they normally are still present when it reaches the consumer. The packaging method just mentioned apparently is intended to facilitate transportation of relatively large quantities of marijuana. A "brick" appears usually to contain about one kilogram of marijuana,[108] and relatively few consumer sales will involve such a large amount, since a kilogram of marijuana will furnish some 3,300 marijuana cigarettes.[109] Smokers appear usually to purchase marijuana by the "bag"—about one-fifth ounce; by the "can"—about one ounce; or by the pound.[110] Hence, after importation "[t]he wholesalers will repackage the marijuana into smaller packages, * * * and they will do it in various ways." [111] We infer that only a small percentage of smokers are likely to learn of the drug's origin from its packaging.

With respect to taste, the Senate hearing record contains the statement of a federal customs agent that "A good marijuana smoker can probably tell good marijuana from bad." [112] As has been seen, there is a preponderance of opinion to the effect that Mexican marijuana is more potent than domestic.[113] One authority states that purchasers of marijuana commonly sample the product before making a "buy." [114] However, the agent quoted above also asserted that some "good" marijuana was grown in Texas. And the account of the sampling custom further states that tasting is merely a ritual since "[u]sually the intoxication will not differ much from one cigarette to another * * *." [115] Once again, we simply are unable to estimate what proportion of marijuana possessors are capable of "placing" the marijuana in their possession by its taste, much less what proportion actually have done so by the time they are arrested.

G.

We conclude that the "knowledge" aspect of the § 176a presumption cannot be upheld without making serious incisions into the teachings of *Tot, Gainey,* and *Romano.* In the context of this part of the statute, those teachings require that it be determined with substantial assurance that at least a majority of marijuana possessors have learned of the foreign origin of their marijuana through one or more of the ways discussed above.

We find it impossible to make such a determination. As we have seen, the materials at our disposal leave us at large to estimate even roughly the pro-

[102] See authorities collected in A. Hodapp, Marijuana: A Review of the Literature for the Analytic Chemist 13 (1959); Bouquet, Cannabis: Parts I–II, 2 Bull. on Narcotics, No. 4, at 14, 21–22 (1950); Ciba Foundation Study Group No. 21, Hashish: Its Chemistry and Pharmacology 33 (1965); J. Simmons (ed.), Marijuana: Myths and Realities 230 (1967).

[103] See authorities cited in n. 100 *supra;* J. Rosevear, Pot: A Handbook of Marijuana 32–33, 68 (1967); Boughey, Pot Scenes East and West 33–34, in J. Simmons (ed.), Marijuana: Myths and Realities (1967); Mayor's Committee on Marijuana, The Marijuana Problem in the City of New York 9 (1944); J. Simmons (ed.), *supra,* at 233.

[104] See J. Rosevear, Pot: A Handbook of Marijuana 32–33 (1967).

[105] See *id.,* at 33.

[106] See 1 Transcript of Pretrial Hearing, *United States* v. *Adams,* 293 F. Supp. 776 (1968), at 16–18, 54 (testimony of Dr. Richard Schultes, Director of Harvard Botanic Museum).

[107] See 2 *id.,* at 19–33 (testimony of Narcotics Agent William Durkin). See also Bureau of Narcotics, Report on the Traffic in Opium and Other Dangerous Drugs 17 (1966). But cf. Senate Hearings 3488–3489.

[108] See J. Simmons (ed.), Marijuana: Myths and Realities 237 (1967); J. Rosevear, Pot: A Handbook of Marijuana 159 (1967); Bureau of Narcotics, Report on the Traffic in Opium and Other Dangerous Drugs 17 (1966). See also Senate Hearings 3489.

[109] See J. Rosevear, *supra,* at 29; Mandel, Myths and Realities of Marijuana Pushing 78, in J. Simmons (ed.), *supra;* Senate Hearings 3489.

[110] See J. Rosevear, *supra,* at 28. See also Mandel, *supra,* at 78.

[111] 2 Transcript of Pretrial Hearing, *United States* v. *Adams,* 293 F. Supp. 776 (1968), at 26 (testimony of Narcotics Agent William Durkin).

[112] Senate Hearings 3489 (prior testimony of Customs Agent Lawrence Fleishman).

[113] See *supra,* at — and n. 102.

[114] See J. Rosevear, Pot: A Handbook of Marijuana 31–33 (1967).

[115] *Id.,* at 32.

portion of marijuana possessors who have learned in one way or another the origin of their marijuana. It must also be recognized that a not inconsiderable proportion of domestically consumed marijuana appears to have been grown in this country, and that its possessors must be taken to have "known," if anything, that their marijuana was *not* illegally imported. In short, it would be no more than speculation were we to say that even as much as a majority of possessors "knew" the source of their marijuana.[116]

Nor are these deficiencies in the foundation for the "knowledge" presumption overcome by paying, as we do, the utmost deference to the congressional determination that this presumption was warranted. For Congress, no less than we, is subject to constitutional requirements, and in this instance the legislative record falls even shorter of furnishing an adequate foundation for the "knowledge" presumption than do the more extensive materials we have examined.

We thus cannot escape the duty of setting aside petitioner's conviction under Count 2 of this indictment.

For the reasons stated in Part I of this opinion we reverse outright the judgment of conviction on Count 3 of the indictment. For the reasons stated in Part II, we reverse the judgment of conviction on Count 2 and remand the case to the Court of Appeals for further proceedings consistent with this opinion. We are constrained to add that nothing in what we hold today implies any constitutional disability in Congress to deal with the marijuana traffic by other means.

Reversed and remanded.

MR. CHIEF JUSTICE WARREN joins Part II of the opinion of the Court and, considering himself bound by the decisions in *Marchetti* v. *United States,* 390 U.S. 39 (1968), *Grosso* v. *United States,* 390 U.S. 62 (1968), and *Haynes* v. *United States,* 390 U.S. 85 (1968), concurs in the result as to Part I.

MR. JUSTICE STEWART concurred in a separate opinion.

MR. JUSTICE BLACK concurred in the result in a separate opinion.

A timely and proper assertion of the constitutional privilege against self-incrimination as defense to a criminal prosecution based on unlawful possession of marijuana by a transferee without having paid the transfer tax is sufficient to dismiss an indictment.

Ct. D. 1929

SUPREME COURT OF THE UNITED STATES

No. 366.—October Term, 1968.

United States, Appellant

v.

Henry Preston Covington

[395 U.S. 57]

On appeal from the United States District Court for the Southern District of Ohio

[May 19, 1969]

MR. JUSTICE HARLAN delivered the opinion of the Court.

This is a companion case to *Leary* v. *United States* [Ct. D. 1928, page 216, this Bulletin], decided today, *ante,* at 395 U.S. 6. Appellee was charged in a one-count federal indictment in the Southern District of Ohio with having violated 26 U.S.C. § 4744(a)(1), a part of the Marijuana Tax Act, by obtaining 737.1 grams of marijuana without having paid the transfer tax imposed by 26 U.S.C. § 4741(a).[1] On appellee's motion, the District Court dismissed the indictment, holding that under principles established in *Marchetti* v. *United States,* 390 U.S. 39 (1968) [Ct. D. 1919, C.B. 1968–1, 500], *Grosso* v. *United States,* 390 U.S. 62 (1968) [Ct. D. 1918, C.B. 1968–1, 495], and *Haynes* v. *United States,* 390 U.S. 85 (1968) [Ct. D. 1920, C.B. 1968–1, 615], appellee's privilege against self-incrimination necessarily would provide a complete defense to the prosecution. 282 F. Supp. 886 (1968).

On motion for reconsideration, the Government advanced the argument, more fully described in *Leary, supra,* at [395 U.S. 6], that the transfer tax provisions of the Marijuana Tax Act do not compel incriminatory disclosures because, as administratively construed and applied, they allow prepayment of the tax only by persons whose activities are otherwise lawful. The District Court responded by ruling in the alternative that if appellee was not required to pay the tax there could be no basis for the indictment. Joint Appendix 20.

The Government appealed directly to this Court pursuant to 18 U.S.C. § 3731, which authorizes direct appeal from the dismissal of an indictment when the decision is one "sustaining a plea in bar" or "is based upon the invalidity or construction of the statute upon which the indictment or information is founded." We noted probable jurisdiction, 393 U.S. 910 (1968),[2]

[116] A careful examination of the lower-court decisions regarding the presumption's constitutionality does not suggest the contrary. All courts of appeals which have ruled on the question have sustained the presumption. See *Caudillo* v. *United States,* 253 F. 2d 513 (C.A. 9th Cir. 1958); *Costello* v. *United States,* 324 F. 2d 260, 263–264 (C. A. 9th Cir. 1963); *United States* v. *Soto,* 256 F. 2d 729, 735 (C.A. 7th Cir. 1958); *Borne* v. *United States,* 332 F. 2d 565, 567 (C.A. 5th Cir. 1964); *United States* v. *Gibson,* 310 F. 2d 79, 82 (C.A. 2d Cir. 1962). However, there is no indication that in any of these cases the court had before it or took into account even a fraction of the evidence which we have considered; in one instance, the lack of evidence was expressly stated to be the ground of decision. See *United States* v. *Gibson, supra.* See also *Costello* v. *United States, supra.* The only lower court which conducted a factual inquiry in any way comparable to our own also held the presumption unconstitutional. See *United States* v. *Adams,* 293 F. Supp. 776 (D.C. S.D.N.Y. 1968).

[1] The relevant provisions of the Marijuana Tax Act are set out and their relationships explained in *Leary* v. *United States, supra,* at 216.

[2] If the dismissal rested on the ground that the Fifth Amendment privilege would be a defense, then the decision was one "sustaining a plea in bar." See *United States* v. *Murdock,* 284 U.S. 141 (1931) [Ct. D. 424, C.B. X–2, 192, (1931)]. If the dismissal was based on a finding that under the Government's construction of the Marijuana Tax Act the indictment stated no defense, then the decision necessarily was "based upon the * * * construction of the statute upon which the indictment was founded." See *United States* v. *Borden Co.,* 308 U.S. 188, 193 (1939).

and the appeal was argued together with *Leary* v. *United States, supra.*

As has been noted, the District Court dismissed the indictment on two alternative grounds. We begin with the second, which was that, assuming the Government's construction of the Marijuana Tax Act to be correct, the indictment did not charge an offense under that statute. Our decision today in *Leary, supra,* makes it plain that this was an improper ground of dismissal, for we have held that the Government's interpretation is incorrect and that the Act requires persons like appellee to prepay the transfer tax. See *ante,* at —.

The District Court's other basis for dismissal was that appellee's Fifth Amendment privilege necessarily would provide a complete defense to the prosecution. We have held today in *Leary* that the privilege does provide such a defense unless the plea is untimely, the defendant confronted no substantial risk of self-incrimination, or the privilege has been waived. See *ante, at* —.[3] See also *Marchetti* v. *United States,* 390 U.S. 39, 61 (1968). The questions remain whether such a plea of the privilege may ever justify dismissal of an indictment, and if so whether this is such an instance.

Federal Rule of Criminal Procedure 12(b)(1) states that "Any defense or objection which is capable of determination without the trial of the general issue may be raised before trial by motion." A defense is thus "capable of determination" if trial of the facts surrounding the commision of the alleged offense would be of no assistance in determining the validity of the defense.[4] Rule 12(b)(4) allows the District Court in its discretion to postpone determination of the motion to trial, and permits factual hearings prior to trial if necessary to resolve issues of fact peculiar to the motion.

In many instances, a defense of self-incrimination to a Marijuana Tax Act prosecution will be "capable of determination without the trial of the general issue." A plea on motion to dismiss the indictment is plainly timely. The question whether the defendant faced a substantial risk of incrimination is usually one of law which may be resolved without reference to the circumstances of the alleged offense. There may more frequently be instances when the issue of waiver will be suitable for trial together with the "general issue." [5] However, the question whether the privilege has been waived also is one of law, and in most cases there will be no factual dispute about it. Hence, we think that a defendant's assertion of the privilege should be sufficient to create a legal presumption of nonwaiver, and thus to require dismissal of the indictment, unless the Government can rebut the presumption by showing a need for further factual inquiries.

Application of these principles to this appeal requires affirmance. Appellee asserted in his motion to dismiss that his possession of marijuana was illegal under Ohio law, and that he would have run a substantial risk of incrimination had he complied with the Act. The District Court reached the same conclusion. The Government appears to acknowledge the illegality of appellee's possession.[6] We conclude that there is no possibility of any factual dispute with regard to hazard of incrimination.

There is in this brief record no indication that appellee waived his privilege, and the Government has never alleged the existence of a factual controversy on that score. Hence, we think it "just under the circumstances" that the case be finally disposed of at this level. See 28 U.S. § 2106; *Grosso* v. *United States,* 390 U.S. 62, 71–72 (1968); *Haynes* v. *United States,* 390 U.S. 85, 100–101 (1968). Accordingly, the judgment of the District Court is *Affirmed.*

MR. CHIEF JUSTICE WARREN, considering himself bound by the decisions in *Marchetti* v. *United States,* 390 U.S. 39 (1968), *Grosso* v. *United States,* 390 U.S. 62 (1968), and *Haynes* v. *United States,* 390 U.S. 85 (1968), concurs in the judgment of the Court.

MR. JUSTICE STEWART joins the opinion and judgment of the Court upon the premise stated in his concurring opinion in *Leary* v. *United States, ante,* p.—.

[3] Leary was convicted under 26 U.S.C. § 4744(a)(2), prohibiting transportation or concealment of marijuana by one who acquired it without having paid the transfer tax, while appellee was indicted under 26 U.S.C. § 4744(a)(1), forbidding such acquisition. We think it clear that there is no significant distinction between the statutes for purposes of the Fifth Amendment privilege.

[4] See 8 J. Moore, Federal Practice ¶ 12.04 (R. Cripes ed. 1968); 2 L. Orfield, Criminal Procedure Under the Federal Rules §§ 12.51–12.60 (1966).

[5] Cf. *Leary* v. *United States, ante,* at —.

[6] See Brief for the United States 3. n. 1.

Chapter 41—Interest Equalization Tax

Subchapter A. Acquisitions of Foreign Stock and Debt Obligations

Section 4911.—Imposition of Tax

(Also Sections 163, 861, 862, 864, 1441, 1442, 1504, 4912, 4915, 4918; 26 CFR 1.163–1, 1.862–1, 1.1441–1, 1.1442–1, 1.1504–1.)

Interest equalization and certain income tax consequences of overseas financing arrangements where a domestic corporation established a wholly-owned domestic subsidiary to obtain funds from foreign persons for purposes of lending such funds to, or investing them in, foreign operating affiliates of the parent.

Rev. Rul. 69–377

Advice has been requested concerning the interest equalization tax and certain income tax consequences under the circumstances described below.

X, a domestic corporation, formed *Y,* also a domestic corporation, as a wholly owned subsidiary. *X* contributed 5,000*x* dollars to the capital of *Y.* In order to provide funds for the development of the businesses of certain of *X*'s foreign affiliates, *Y* sold 25,000*x* dollars of 20-year debt obligations to foreign persons through a public offering in foreign countries and invested

in or loaned to the foreign affiliates of *X* the funds thus derived.

The debt obligations of *Y* are convertible into the capital stock of *X*. Payments of the principal and interest on the debt obligations and the performance of the obligation to convert the debt obligations into *X*'s capital stock are guaranteed by *X*, so that in the event *Y* fails to make any such payments on time, or fails to perform its obligation to convert, *X* will cause such payment to be made, or will perform the obligation to convert. All other indicia of bona fide indebtedness exist with respect to the debt obligations of *Y*.

Section 4911 of the Internal Revenue Code of 1954 imposes the interest equalization tax on each acquisition by a United States person of stock of a foreign issuer, or a debt obligation of a foreign obligor, if such obligation has a period remaining to maturity of one year or more.

Section 4912(b)(3) of the Code provides, in part, that the acquisition of stock or a debt obligation of a domestic corporation, formed or availed of for the principal purpose of obtaining funds (directly or indirectly) for a foreign issuer or obligor, shall be deemed an acquisition (from such foreign issuer or obligor of) stock or a debt obligation of such foreign issuer or obligor.

Section 4918(a) of the Code provides, in relevant part, that the interest equalization tax shall not apply to an acquisition of stock of a foreign issuer or a debt obligation of a foreign obligor if it is established in the manner provided in that section that the person from whom such stock or debt obligation was acquired was a United States person throughout the period of his ownership or continuously since July 18, 1963, and was not ineligible to dispose of such stock or debt obligation as a United States person and such person had paid the tax imposed by section 4911 of the Code with respect to the acquisition of such stock or debt obligation by such person or acquired such stock or debt obligation without liability for payment of such tax.

Since *Y* was formed or availed of for the principal purpose of obtaining funds for a foreign issuer or obligor pursuant to section 4912(b)(3) of the Code, the stock and the debt obligations issued by *Y* are deemed to be the stock of such foreign issuer or the debt obligation of such foreign obligor. Therefore, the acquisition by United States persons of such stock or debt obligations of *Y* is subject to the interest equalization tax unless one or more specific statutory exemptions is applicable.

In order to warn United States persons who acquire the stock or the debt obligations of *Y* of interest equalization tax liability, *Y* placed a legend on its capital stock and on the debt obligations which read, as applicable, substantially as follows:

United States Interest Equalization Tax

"The issuer of this debt obligation [or stock] has been formed or availed of for the principal purpose of obtaining funds (directly or indirectly) for foreign issuers or foreign obligors. Consequently the United States Internal Revenue Service has ruled that United States persons (as that term is defined in Section 4920(a)(4) of the U.S. Internal Revenue Code of 1954) will be required to report and pay United States interest equalization tax with respect to acquisition of this debt obligation [or stock] except where a specific statutory exemption is applicable."

Y invested the net proceeds from the sale of the debt obligations and the cash contributed by *X* in foreign corporations by acquiring the stock or debt obligations of such foreign corporations.

Section 4915(a) of the Code provides, in relevant part, that the interest equalization tax imposed by section 4911 of the Code shall not apply to the acquisition by a United States person of stock or debt obligations of a foreign corporation if immediately after the acquisition such person (or one or more includible corporations in an affiliated group, as defined in section 1504 of the Code, of which such person is a member) owns directly or indirectly 10 percent or more of the total combined voting power of all classes of stock of such foreign corporation.

Section 1504(a) of the Code provides that the term "affiliated group" means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if:

(1) Stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the nonvoting stock of each of the includible corporations (except the common parent corporation) is owned directly by one or more of the other includible corporations; and

(2) The common parent corporation owns directly stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the nonvoting stock of at least one of the other includible corporations.

Section 4915(c)(1) of the Code provides that section 4915(a) of the Code shall be inapplicable in any case where the foreign corporation is formed or availed of by the United States person for the principal purpose of acquiring, through such foreign corporation, an interest in stock or debt obligations of one or more *other* foreign issuers or obligors, the direct acquisition of which by the United States person would be subject to the interest equalization tax imposed by section 4911 of the Code.

Section 4915(d) of the Code provides that section 4915(a) of the Code shall be inapplicable in any case where the acquisition of stock or debt obligations of the foreign corporation is made with intent to sell, or to offer to sell, any part of the stock or debt obligations acquired to United States persons.

Accordingly, under section 4915(a) of the Code, subject to the exceptions set forth in sections 4915(c) and 4915(d) of the Code, the interest

equalization tax does not apply to the acquisition by *Y* of the stock or debt obligations of a foreign corporation, if *X* or *Y* owns 10 percent of the total combined voting power of all classes of stock of such foreign issuer or obligor immediately after such acquisition by *Y*, and *X* and *Y* constitute an affiliated group pursuant to section 1504 of the Code.

Section 163(a) of the Code provides that there shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness.

Accordingly, since the debt obligations of *Y* have all the indicia of bona fide indebtedness, the interest paid by *Y* on each debt obligation of *Y* is deductible under section 163(a) of the Code so long as such debt obligation is held by a person other than *X* or one of its affiliates.

Y derived more than 80 percent of its gross income from the dividends and interest paid on stock or debt obligations of foreign issuers and obligors.

Section 1441(a) of the Code provides, in relevant part, that all persons, in whatever capacity acting, having the control, receipt, custody, disposal, or payment of any of the items of income specified in section 1441(b) of the Code (which section includes interest) to the extent that any of such items constitutes gross income from sources within the United States, of any nonresident alien individual, or of any foreign partnership, shall deduct and withhold from such items a tax equal to 30 percent thereof.

Section 1442 of the Code provides, in relevant part, that in the case of foreign corporations, subject to income taxation under the Code, there shall be deducted and withheld at the source in the same manner and on the same items of income as is provided in section 1441 of the Code a tax equal to 30 percent thereof.

Section 862(a)(1) of the Code provides, in relevant part, that interest other than that derived from sources within the United States as provided in section 861(a)(1) of the Code shall be treated as income from sources without the United States.

Section 861(a)(1)(B) of the Code provides, in relevant part, that interest on obligations of a domestic corporation shall be treated as income from sources within the United States unless it is shown to the satisfaction of the Secretary or his delegate that less than 20 percent of the gross income from all sources of such domestic corporation has been derived from sources within the United States, as determined under the provisions of sections 861, 862, 863 and 864 of the Code for the 3-year period ending with the close of the taxable year of such domestic corporation preceding the payment of such interest, or for such part of such period as may be applicable.

Section 861(d) of the Code provides, in relevant part, that for purposes of section 861(a)(1)(B) of the Code if the domestic corporation has no gross income from any source for the 3-year period (or part thereof) specified, the 20 percent test shall be applied with respect to the taxable year of the payer in which payment of the interest is made.

Accordingly, no United States withholding of tax under section 1441 or 1442 of the Code is required on the interest from the debt obligations of *Y* paid to nonresident alien individuals, foreign partnerships or foreign corporations, if less than 20 percent of *Y*'s gross income has been derived from sources within the United States pursuant to sections 861 through 864 of the Code.

Whether a debt obligation issued by *Y*, if acquired by *X* or one of its affiliates or if *X* or one of its affiliates makes any payment of principal or interest on such debt obligation pursuant to *X*'s guaranty to make payments of principal and interest in the event that *Y* fails to make such payments, is bona fide indebtedness and whether interest paid or accrued on such debt obligation by *X* or one of its affiliates is deductible are questions to be determined on the basis of all the facts and circumstances of each case.

Section 4912.—Acquisitions

Federal income tax and interest equalization tax consequences of an "overseas financing" arrangement. See Rev. Rul. 69–377, page 231.

Section 4915.—Exclusion for Direct Investments

Federal income tax and interest equalization tax consequences of an "overseas financing" arrangement. See Rev. Rul. 69–377, page 231.

26 CFR 147.2–1: Credit or refund in case of direct investments.

Whether the investment by a domestic corporation in the stock of a wholly-owned foreign subsidiary formed to sell debt obligations to provide working capital for expansion purposes by the domestic corporation qualifies as a direct investment for purposes of section 4915 of the Code.

Rev. Rul. 69–501

Advice has been requested whether the transactions described below will qualify as a direct investment for the purposes of section 4915 of the Internal Revenue Code of 1954.

X, a domestic corporation, formed *N*, a foreign subsidiary corporation, for the purpose of providing working capital and funds for expansion of *X*'s business both in the United States and abroad through its other affiliates. To accomplish this financing *N* sold 20-year debt obligations to underwriters for offer and sale to the public outside the United States. The proceeds from the sale of these debt obligations were loaned to *X* and invested in and loaned to certain of *X*'s affiliated companies at interest by *N*. The debt obligations of *N* are convertible into the capital stock of *X*. Payment of the principal and interest on the debt obligations are guaranteed by *X*.

Before the date on which the debt obligations were issued by, *N*, *X* purchased all of the capital stock of *N* for an amount of cash equal to 20 percent of the principal amount of the total debt obligations to be issued by *N*. The money used by *X* to make this invest-

ment in *N* was borrowed from a foreign financial institution. Upon receipt of this money from *X*, *N* deposited said money with the same foreign financial institution. *N*'s right to withdraw the money so deposited was not contingent upon repayment of the loan incurred by *X* from that same foreign financial institution, nor was this deposit to be considered as collateral for repayment of *X*'s loan.

Section 4911 of the Code imposes the interest equalization tax on each acquisition by a United States person of stock of a foreign issuer, or a debt obligation of a foreign obligor, if such obligation has a period remaining to maturity of one year or more.

Section 4915(a) of the Code provides, in relevant part, that the tax imposed by section 4911 of the Code shall not apply to the acquisition by a United States person of stock or debt obligation of a foreign corporation if immediately after the acquisition such person owns directly or indirectly 10 percent or more of the total combined voting power of all classes of stock of such foreign corporation.

Subsection (c) of section 4915 of the Code, provides that section 4915(a) of the Code shall be inapplicable in any case where the foreign corporation is formed or availed of by the United States person for the principal purpose of acquiring, through such foreign corporation, an interest in stock or debt obligations of one or more other foreign issuers or obligors, the direct acquisition of which by the United States person would be subject to the interest equalization tax imposed by section 4911 of the Code.

Subsection (d) of section 4915 of the Code provides that section 4915(a) of the Code shall be inapplicable in any case where the acquisition of stock or debt obligations of the foreign corporation is made with intent to sell, or to offer to sell, any part of the stock or debt obligations acquired to United States persons.

Accordingly, it is held that under section 4915(a) of the Code, subject to the exceptions set forth in sections 4915(c) and (d) of the Code, the interest equalization tax does not apply to the acquisition by *X* of the stock or debt obligations of *N*, since in the instant case *X* owns more than 10 percent of the total combined voting power of all classes of stock issued by *N*, immediately after the acquisition of such stock. However, any other United States person acquiring the debt obligations of *N* will be subject to the tax imposed by section 4911 of the Code unless a specific exemption or exclusion is applicable. Furthermore, any acquisition of the capital stock of *X* into which the debt obligations are convertible, whether upon conversion or from any other person, will not be subject to the tax imposed by section 4911 of the Code. For the purpose of section 4919 of the Code a United States person acting as a dealer or underwriter with respect to the debt obligations may avail himself of the credit or refund therein provided the applicable requirement of such section and the temporary regulations thereunder are met.

Section 4916.—Exclusion for Investment in Less Developed Countries

26 CFR 147.3–1: Exclusion for investments in less developed country corporations.

An extension of the period for furnishing information relative to a foreign corporation's qualification as a less developed country corporation for purposes of exclusion from interest equalization tax cannot be granted where the application for extension is not timely filed.

Rev. Rul. 69–520

Advice has been requested whether an extension of the period for furnishing certain information required by section 147.3–1(e)(2)(x)(*b*) of the Temporary Regulations (relating to the qualification of a foreign corporation as a less developed country corporation for purposes of the exclusion from the interest equalization tax provided by section 4916(a) of the Internal Revenue Code of 1954 for stock or debt obligations of such corporations) can be granted where the application for the extension is not made within the period prescribed for making the application.

The taxpayer, a foreign corporation, was issued a ruling that it qualified as a less developed country corporation for its annual accounting period ending December 31, 1968, and that acquisitions by United States persons of stock or debt obligations of such corporation during such period are exempt from interest equalization tax under the provisions of section 4916(a) of the Internal Revenue Code of 1954. Subsequent to March 31, 1969, the taxpayer requested an extension of time within which to furnished certain information required by section 147.3–1(e)(2)(x)(*b*) of the regulations.

Section 147.3–1(e)(2)(x)(*b*) of the regualtions requires the foreign corporation to furnish certain information to the Commissioner of Internal Revenue within 90 days after the close of the annual accounting period with respect to which a ruling was issued. Timely filing of such information also constitutes a request for a ruling for the next succeeding annual accounting period. The Commissioner may grant reasonable extensions of the 90-day period upon application made within such period and based upon inability to obtain the information within such perod.

Section 147.3–1(e)(5) of the regulations states that a ruling issued that a foreign corporation shall be treated as a less developed country corporation expires if the information required under section 147.3–1(e)(2)(x)(*b*) of the regulations is not furnished within the time prescribed (including extensions of time) by such section. Any acquisition of stock or debt obligations of such corporation after the date of expiration of the ruling (the 90th day after the close of the annual accounting period of the corporation with respect to which the ruling was issued) will be treated as an acquisition of stock or debt obligations of a foreign corpora-

tion which is not a less developed country corporation.

Section 147.3–1(e)(2)(x)(*b*) of the Temporary Regulations is explicit in requiring that an application for an extension of the 90-day period for filing the information required by that section be made within such period. An extension of time cannot be granted where the application for such extension is not made within the prescribed 90-day period.

Accordingly, since the taxpayer in the instant case did not make application for an extension of the 90-day period before the expiration of such period (March 31, 1969), an extension of time within which to file the required information cannot be granted.

Thus, under section 147.3–1(e)(5) of the regulations, the ruling issued to the taxpayer for its annual accounting period ending December 31, 1968, expired on March 31, 1969, and any acquisition of stock or debt obligations of the taxpayer by a United States person after March 31, 1969, shall be treated as an acquisition of stock or debt obligations of a foreign corporation which is not a less developed country corporation for purposes of the exclusion from the interest equalization tax provided by section 4916(a) of the Code. However, the taxpayer may request a ruling pursuant to the procedures contained in section 147.3–1(e) of the regulations that it is a less developed country corporation for the remaining part of its annual accounting period ending December 31, 1969.

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26 CFR 147.3–1: Exclusion for investments in less developed country corporations.

Revised listing of foreign corporations that qualify as less developed country corporations for purposes of exemption from interest equalization tax; Revenue Rulings 66–1, 67–142, and 68–110 superseded.

Rev. Rul. 69–554

The purpose of this Revenue Ruling is to include in one list foreign corporations that have as of August 15, 1969, received ruling letters from the Internal Revenue Service holding that they qualify as less developed country corporations for respectively stated periods relative to the interest equalization tax. The conclusion in each such ruling letter was based on a determination that the foreign corporation met the requirements of section 147.3–1(e) of the Temporary Regulations, C.B. 1964–2, 906. The effect of such a conclusion is that acquisitions by United States persons of stock or debt obligations of such corporations during the periods such corporations qualified as less developed country corporations are exempt from the interest equalization tax under the provisions of section 4916(c)(4) of the Internal Revenue Code of 1954.

The corporations listed below include corporations which currently qualify as less developed country corporations for purposes of section 4916(c)(4) of the Code as well as corporations whose status as less developed country corporations have expired or have been terminated. For this reason, taxpayers are cautioned that the dates following the names of the corporations are important.

Aaron Maritime Co., Ltd.—10/27/66 to 1/29/67.

Adela Investment Company, S.A.—9/24/64 to 9/30/69.

Adonis Navigation Co., Ltd.—1/17/69 to 2/28/70.

Aegean Marine Corporation—4/23/69 to 5/29/70.

Agronorte Ltd., S.A.—8/7/68 to 6/30/69.

Air Caribbean Transport Limited—12/4/67 to 3/31/70.

American-Asiatic Oil Corporation—7/30/68 to 3/31/70.

American Israeli Paper Mills, Ltd.—7/19/63 to 6/30/69.

Andacollo Mining Company, Ltd.—9/16/66 to 7/30/69.

Anglo-Lautaro Nitrate Company, Ltd.—7/19/63 to 9/29/69.

Antilles International Salt Company, N.V.—10/26/65 to 9/28/69.

Antilles Steamship Company, Ltd.—8/31/67 to 3/31/69.

Arctic LNG Transportation Company—4/19/68 to 3/31/69.

Arger Navigation Ltd.—10/27/66 to 7/29/67.

Aris Steamship Company, Ltd.—3/27/67 to 1/29/68.

Attica Maritime Ltd.—12/26/68 to 2/28/70.

Banco de Investimento and Desenvoluimento Industrial, S.A.—3/29/67 to 4/1/68.

Bank Leumi Le-Israel B.M.—5/3/65 to 3/31/70.

Banque Internationale pour L'Afrique Occidentale—4/1/65 to 4/1/68.

Bantry Transportation Co.—9/6/66 to 3/31/70.

Barracuda Tanker Corp.—2/8/65 to 9/28/69.

Benguet Consolidated, Inc.—7/19/63 to 8/20/68.

Bogo-Medellin Milling Co., Inc.—7/20/65 to 12/29/69.

Botswana RST Limited—3/20/68 to 3/31/70.

Brascan, Limited—2/18/65 to 3/31/70 (formerly Brazilian Light & Power Co., Inc.).

British West Indian Airways Limited—8/29/68 to 3/31/70.

Brown Brothers de Mexico, S.A.—4/11/66 to 3/31/70.

Calabrian (Thailand) Co., Ltd.—6/30/67 to 6/30/69.

Calbiochem Africa Limited—4/30/69 to 3/31/70.

Canadian International Power Co., Ltd.—7/19/63 to 3/31/70.

Caribbean Cement Company, Ltd.—6/2/67 to 3/31/70.

Caribbean Empire Company, Ltd.—7/2/68 to 3/31/69.

Caribbean Sulphur Shipping Company of Liberia—6/22/67 to 3/31/70.

Caxinas, S. de R.L.—5/20/66 to 3/31/69.

Cayman Island Shipping Company, Ltd. (formerly Island Shipping Company, Ltd.)—7/6/67 to 3/31/69.

Central American Allied Investors, S.A.—1/12/66 to 3/31/70.

CE-rrey, S.A.—6/24/66 to 3/31/70.

Coastal Caribbean Oils & Minerals, Inc.—4/4/65 to 3/31/69.

Communicaciones, S.A.—7/29/66 to 1/29/68.
Companhia-Minera Do Lobito, S.A.R.L.—4/5/67 to 3/31/70.
Compania de Luz y Fuerza del Centro, S.A.—11/25/64 to 3/31/69.
Compania de Celulose do Ultramar Portugues, S.A.R.L.—2/4/66 to 3/31/67.
Compania Desarrolladora Panamena, S.A.—6/27/67 to 3/31/69.
Compania Shell de Venuzuela, Ltd.—5/25/65 to 3/31/70.
Consolidated Halliwell Ltd.—7/19/63 to 3/31/70.
Consolidated Mines, Inc.—10/13/65 to 3/31/66.
Construcciones Gilbane de Columbia, S.A. (formerly Limitoda)—4/28/67 to 3/31/70.
Construcciones Populares, S.A. de C.V.—7/8/65 to 3/31/66.
Constructora de Vivendas de Bogata, Ltda.—11/28/66 to 6/30/67.
Constructora y Urbanizadora Escambia S.A. de C.V.—8/15/68 to 3/31/70.
Credit and Development Corporation—5/17/65 to 3/31/70.
Deltec Panamerica Corp.—3/13/66 to 12/29/69.
ECL Industries, Inc.—5/26/69 to 3/31/70.
ECL Industries, Ltd.—7/19/63 to 3/31/70.
EHMO S.A.—3/7/68 to 12/30/68.
Ensom City Limited—4/23/65 to 3/31/66.
Equadorian Corporation, Limited—7/19/63 to 3/31/66.
Etz Lavud Limited—7/22/69 to 6/29/70.
Evie Navigation Co., Ltd.—10/24/67 to 11/29/68.
Fieldston Navigation Co., Inc.—8/7/68 to 8/31/69.
Financiera Bancomer, S.A.—3/18/69 to 3/31/70.
Financiera Metropolitana, S.A.—12/10/68 to 3/31/70.
Golarfruit, Inc.—4/11/66 to 3/31/67.
Grand Bassa Tankers, Inc.—1/25/65 to 3/31/70.
Hawaiian-Philippine Company—8/3/65 to 12/29/69.
Heinz Alimentos S.A. de C.V.—12/13/66 to 7/29/67.
Hotel Condesa del Mar, S.A.—7/24/68 to 3/31/70 (formerly, Hotel Ritz Acapulco, S.A.).
Inagua Bay, Inc.—3/18/68 to 3/31/69.
Inaugua Spray, Inc.—7/25/67 to 3/31/69.
Industria Electrica de Mexico, S.A.—7/19/63 to 3/31/70.
Intercontinental Maritime Ltd.—9/27/67 to 9/30/68.
Interhemisphere Transport Co.—6/29/66 to 3/31/70.
International Scientific, Ltd.—6/28/68 to 3/31/69.
IPC Finance Ltd.—3/7/66 to 5/29/70.
Iran Shell, N.V.—7/27/66 to 3/31/67.
Israel Corporation, Ltd. (The)—6/30/69 to 3/31/70.
Israel Discount Bank, Ltd.—1/1/64 to 3/31/69.
Jamaica Public Service, Ltd.—1/11/65 to 3/31/70.
Jamaica Telephone Company, Ltd. (The)—7/16/69 to 3/31/70.
Jardines de Guadelupe, S.A.—5/25/67 to 11/29/68.
Kilembe Copper Cobalt Ltd.—11/4/65 to 3/31/70.
Kupat-Am Bank Ltd.—8/3/65 to 3/31/69.
LaGloria Palacios, S.A. de C.V.—9/30/65 to 3/31/67.
La Luz Mines Limited—11/23/65 to 12/29/69.
La Tabacalera Mexicana, S.A.—7/19/63 to 11/2/64 and 5/7/65 to 3/31/66.
Lepanto Consolidated Mining Co.—6/9/66 to 3/31/70.
Liberian Iron Ore Ltd.—7/19/63 to 3/31/70.
Luzon Stevedoring Corp.—9/30/65 to 3/31/67.
Marcopper Mining Corp.—10/5/67 to 3/31/70.
Marinduque Mining and Industrial Corporation—5/16/67 to 3/31/70.
Mexican Light and Power Co. Ltd.—7/19/63 to 3/31/69.
Midepsa Industries Limited—11/24/65 to 7/29/69.
Moran International Towing Corp.—3/31/66 to 3/31/70.
Motorship Tankers, Inc.—11/30/6[illegible] to 3/31/66.
National Iranian Tanker Company (Monrovia), Ltd.—7/19/63 to 11/2/64 and 11/30/64 to 3/31/66.
Naviera Panamericana, S.A.—4/11/66 to 3/31/67.
Nchanga Consolidated Copper Mines Limited—7/25/67 to 9/27/69.
Nicaraguan Hotel Company, Ltd. (The)—11/30/67 to 3/31/70.
Norsul Oil & Mining Ltd.—3/9/65 to 7/29/69.
Ocean Oil Traders, Inc.—4/11/66 to 3/31/67.
Ocean Oil Transport, Inc.—4/11/66 to 3/31/67.
Ocean Ore Shipping Corp.—4/11/66 to 3/31/67.
Oriole Shipping Corp.—4/11/66 to 3/31/67.
Oswego Chemical Carriers Corp.—7/24/65 to 3/31/70.
Oswego Marine Corp.—8/27/65 to 3/31/70.
Oswego Navigation Corp.—10/21/65 to 3/31/70.
Oswego Tanker Corp.—2/25/65 to 3/31/70.
Oswego Unity Corp.—11/10/65 to 3/31/70.
Pago Mining Limited—5/20/68 to 3/31/69.
Pasco International Limited—6/16/67 to 3/31/70.
Pato Consolidated Gold Dredging Limited—7/19/63 to 3/31/70.
Parimentos Mexicanos—8/2/67 to 3/31/68.
Peruvian Investment & Finance Ltd.—6/16/66 to 9/28/67.
Philex Mining Corp.—10/28/68 to 3/31/70.
Philippine Long Distance Telephone Co.—11/30/64 to 3/31/70.
Philippine Oil Development Co., Inc.—7/19/63 to 11/2/64 and 11/24/64 to 3/31/66.
Polar LNG Shipping Corp.—4/19/6[illegible] to 3/31/69.
Premier Consolidated Oilfields, Ltd.—7/19/63 to 6/31/69.

Private Investment Company for Asia, S.A.—12/26/68 to 3/31/70.
Proyecto Viru Sociedad Anomina—5/17/65 to 4/1/68.
P.T. Indonesian Satellite Corporation—1/19/68 to 3/31/70.
Purina Korea Inc.—12/21/67 to 4/1/68.
Rhokana Corporation Limited—7/25/67 to 9/28/69.
Roan Selection Trust Ltd.—1/25/65 to 9/28/69.
Rocky Point Development Co., Ltd. (The)—6/3/69 to 5/1/70.
Rosita Mines Limited—11/23/65 to 12/29/67.
San Carlos Milling Co., Inc.—7/19/63 to 3/31/70.
San Jose Oil Company, Inc.—1/6/65 to 3/31/70.
San Miguel Corporation—7/19/63 to 3/31/70.
Servicio Pan Americano de Proteccion, C.A. (Venezuela)—10/30/68 to 3/31/70.
Servicio Pan Americano de Proteccion, S.A.—10/25/68 to 9/29/69.
Shell Exploratie en Productia Mastschappij, N.V.—5/25/65 to 3/31/66.
Shell Finance (Development) Co., Ltd.—5/25/65 to 3/31/67.
Shell Quimica de Venezuela, C.A.—5/25/65 to 3/31/70.
Signess Shipping Company, Inc.—11/30/64 to 3/31/67.
Societe Hoteliere de la Baie de Marigot, S.A.—12/13/66 to 3/31/70.
Space Marine Transport Company—9/23/65 to 3/31/69.
Standard (Philippines) Fruit Corp.—9/1/66 to 3/31/70.
Sterling Tankers Corporation—10/27/65 to 3/31/67.
TACA International Airlines, S.A.—10/22/65 to 3/30/68.
TAW International Leasing Corporation—12/11/68 to 11/29/69.
Telefonos de Mexico—4/29/66 to 3/31/70.
Trans-Mediterranean Airways, S.A.L.—10/24/67 to 4/1/68.
Trinity Marine Corporation—1/1/64 to 3/31/70.
Trinity Navigation Corporation—11/25/64 to 3/31/70.
Triple Ocean Operation, Inc.—4/11/66 to 3/31/67.
Tropical Gas Co., Inc.—9/16/66 to 3/31/70.
Tropigas Carriers, Inc.—7/16/68 to 3/31/70.
Tropigas Tankers, Inc.—9/28/66 to 3/31/70.
Tubos de Acero de Mexico, S.A.—7/19/63 to 3/31/70.
Twin Americas Agricultural & Industrial Developers, Inc.—12/21/67 to 9/28/69.
Twin Ocean Operation, Inc.—4/11/66 to 3/30/68.
Ultrafertil S.A.—9/14/67 to 12/29/69.
Urbanizaciones Guacara, C.A.—5/6/65 to 4/1/68.
Urbanizaciones Guayance, C.A.—1/17/67 to 3/31/69.
Victorias Milling Co., Inc.—6/20/67 to 1/31/70.
Westwaters Shipping Inc.—1/28/65 to 4/1/68.
West Indies Plantations, Limited—2/29/68 to 12/29/69.
Zambian Anglo American, Limited—7/25/67 to 9/28/69.

The Service, from time to time, will publish updated lists of corporations qualifying as less developed country corporations for certain stated periods.

Revenue Ruling 66–1, C.B. 1966–1, 259, Revenue Ruling 67–142, C.B. 1967–1, 311, and Revenue Ruling 68–110, C.B. 1968–1, 515, are hereby superseded.

Section 4918.—Exemption for Prior American Ownership and Compliance

Federal income tax and interest equalization tax consequences of an "overseas financing" arrangement. See Rev. Rul. 69–377, page 231.

Section 4920.—Definition and Special Rules

26 CFR 147.7–2: Foreign stock issues treated as domestic stock issues.

Listing of foreign corporations that have received rulings holding certain classes of their stock exempt from interest equalization tax; further, certain acquisitions of common stock of Surluga Gold Mines Limited, Husky Oil Canada Limited, and MacDonald Mines Limited may be exempt; Revenue Rulings 67–196, 67–454, 68–135, and 68–466 superseded.

Rev. Rul. 69–555

The Internal Revenue Service has issued ruling letters to a number of foreign corporations holding certain classes of their stock exempt from the interest equalization tax, pursuant to section 4920(b) (formerly 4920(a)(8)) of the Internal Revenue Code of 1954. This Revenue Ruling contains a list of foreign corporations that as of August 15, 1969, have received such letters and updates the list previously published in Revenue Ruling 67–196, C.B. 1967–1, 313, as modified by Revenue Ruling 67–454, C.B. 1967–2, 405, Revenue Ruling 68–135, C.B. 1968–1, 523, and Revenue Ruling 68–466, C.B. 1968–2, 563.

The classes of stock of such foreign corporations that satisfy the requirements of section 4920(b) of the Code are treated not as foreign stock issues but as domestic issues. Accordingly, United States persons that acquire shares of such a class of stock are not subject to the interest equalization tax.

These ruling letters exempt only those shares included in the term "class of stock" as defined in section 4920(b)(2) of the Code. The term "class of stock" means all shares of stock of a corporation issued and outstanding as of the corporation's latest record date before July 19, 1963, which are identical with respect to rights and interests such shares represent in the control, profits, and assets of the corporation. The term also includes additional shares possessing rights and interests identical with the rights and interests of shares described in the preceding sentence if such additional shares have been (1) issued on or before November 10, 1964; (2) issued after November 10, 1964, pursuant to a written commitment made by such corporation on or before such

date; (3) issued after November 10, 1964, to a shareholder with respect to or in exchange solely for shares described in this paragraph; or (4) issued in accordance with section 4920 (b) (2) (D) of the Code.

Some corporations receiving ruling letters under section 4920(b) of the Code to issue shares of stock which, although similar to the exempt class, do not qualify for the exemption. In such cases, in order that the previously issued ruling letter not be adversely affected, the Service has specified that nonqualifying shares are to be identified by a legend on the stock certificate by which they can easily be distinguished from the exempt class of stock.

Corporations issuing both exempt stock and similar stock which does not qualify as part of the exempt class of stock (so-called legend stock) are listed separately below. Since this list of corporations issuing nonqualifying legend shares may be modified from time to time, United States persons should ascertain before acquisition of shares of stock of any of such listed corporations whether the shares are exempt or nonexempt.

From time to time other lists will be published of those corporations which have received rulings during the period subsequent to this Revenue Ruling.

The corporations listed below have received ruling letters under section 4920(b) of the Code holding that the class of stock described for each corporation is exempt from the interest equalization tax:

Alcan Aluminum Limited—common stock without nominal or par value.

Alliance Tire & Rubber Company Limited—class A stock.

Allied-Roxana Minerals Limited—common stock with nominal par value.

Alscope Consolidated Limited—common stock.

Asamera Oil Corporation Ltd.—common capital stock.

Atlas Consolidated Mining & Development Corp.—common stock.

Avco Delta Corporation Limited (formerly Delta Acceptance Corporation Limited)—first preference share $100 par value, series B 5½ percent cumulative redeemable sinking fund shares; second preference shares $100 par value, series A 5½ percent cumulative convertible shares and common stock no par value.

Beauty Counselors of Canada, Ltd.—common stock without par value issued prior to 11/10/64.

Blue Crown Petroleums Ltd.—common stock.

Brilund Mines Limited — common stock.

Cabol Enterprises Limited—common stock without par value.

Calgary & Edmondton Corporation Ltd. (The)—capital stock without nominal or par value.

Canada Southern Petroleum Ltd.—capital stock and voting trust certificates relating thereto.

Canada Southern Railway Company—common stock.

Canadian Export Gas & Oil Limited—common stock.

Canadian Homestead Oils, Limited—common stock.

Canadian Javelin Limited—common stock without par value.

Canadian Superior Oil Limited—common stock with $1 par value.

Canadian Westinghouse Company, Ltd.—common stock without nominal or par value.

Chemalloy Minerals Limited—common stock, par value $1.

Columbia Cellulose Company, Ltd.—common stock without nominal or par value.

Consolidated Marbenor Mines, Limited—common stock.

Consolidated Panther Mines Limited—common stock.

Continental Research & Development Limited—common stock.

Crow's Nest Industries Limited—common stock (formerly Crow's Nest Pass Coal Company, Limited).

Dome Mines Limited—stock without nominal or par value.

Dome Petroleum Limited—common stock, par value $2.50.

Elite Cobalt Mines Limited—common stock.

Exquisite Form Brassiere (Canada) Ltd.—common shares no par value.

Fargo Oil Ltd.—common stock, par value $1.

Ford Motor Company of Canada Ltd.—common stock without par value.

Fruehauf Trailer Company of Canada Ltd.—common stock without nominal or par value.

Glen Lake Silver Mines, Ltd.—common stock.

Wm. Gluckin Company Limited—5 percent convertible preferred stock and common stock, each par value one pound.

Golden Age Mines Limited—common stock (no par value).

Goodyear Tire & Rubber Company of Canada Limited (The)—common stock.

Granby Mining Company Limited (The)—common stock.

Greyhound Lines of Canada Limited—common stock.

Hudson's Bay Oil and Gas Co., Ltd.—capital stock par value of $2.50.

Imperial Oil Limited—capital stock, without nominal or par value.

Indian Mountain Metal Mines, Limited—common stock.

Initiative Explorations Limited—common stock.

International Nickel Company of Canada, Ltd. (The)—common stock without nominal or par value.

James A. Lewis Engineering Co. Ltd.—common stock.

Jefferson Lake Petrochemicals of Canada, Ltd.—common stock.

Jenkins Bros. Limited—common stock.

Kardar Canadian Oils Limited—common stock.

Magellan Petroleum Corporation—common capital stock par value $.01 and voting trust certificates relating thereto.

Monarch Fine Foods Limited—common stock without par value.

Murphy Oil Company Limited—common stock.

National Malartic Gold Mines Limited—common stock.
National Petroleum Corporation Ltd.—capital stock, par value $.25.
New Cayzor Athabaska Mines Limited (formerly Cayzor Athabaska Mines Limited)—common stock.
North Canadian Oils Limited—common stock, par value $.25.
Northwest Nitro-Chemicals Limited—common stock.
O'Okiep Copper Company Limited—ordinary shares, par value 1 Rand.
Orofino-Mines Limited—common stock.
Pacific Petroleums Ltd.—common stock par value $1.
Pago Mining Limited—capital without par value.
Pancoastal Petroleum Limited—common capital stock voting trust certificates relating thereto.
Pantepec Oil Company, C.A.—capital stock par value one bolivar.
Peel-Elder Limited—capital stock of no par value.
Peruvian Oils & Minerals Limited—capital stock.
Phoenix Canada Oil Company Limited—common stock.
Pompey Oil & Minerals Company Limited—common stock.
Prairie Oil Royalties Company Ltd.—capital stock.
Reeves MacDonald Mines Limited—common stock.
Sailfish Sports Craft Limited—common stock.
Schlumberger Limited—common stock.
Scott Paper Limited—common stock without nominal or par value.
Scurry-Rainbow Oil Limited—common stock.
Silver Ridge Mining Co., Limited—common stock.
Snowdrift Base Metal Mines Limited—common stock.
Stanrock Uranium Mines Limited—common stock.
St. John d 'el Rey Mining Co., Ltd.—shares of ordinary stock.
Syntex Corporation—common stock.
TACA International Airlines S.A.—common stock $.10 par value.
Texaco Canada Limited—common stock without nominal or par value.
Tropical Gas Company, Inc.—common stock and preferred.
Union Carbide Canada Limited—common stock without nominal or par value.
Union Oil Company of Canada Limited—common stock.
United Asbestos Corporation Limited—capital stock, $1 par value.
United Canso Oil & Gas Limited—capital stock, par value $1 and voting trust certificate relating thereto.
Vanadium-Alloys Steel Canada Limited—common stock, no par value.
Vascan Limited—common stock, no par value.
Western Heritage Properties Limited—common stock.

The corporations listed below have received ruling letters holding that the described class or classes of their stock are exempt under section 4920(b) of the Code, but have subsequently issued additional shares which are not exempt, even though they are similar in rights and interest to the exempt shares:

Banff Oil Limited—common stock and preferred stock.
Canadian Curtiss-Wright Limited—capital stock.
Coastal Caribbean Oils & Minerals Ltd.—capital stock, par value 1 shilling and voting trust certificates relating thereto.
Molybenite Corporation of Canada Ltd.—common stock with par value $1.
Murky Fault Metal Mines Limited—common stock.
Tashota Nipigon Mines Limited—common stock.
Warner Bros. Seven Arts Limited (formerly Seven Arts Productions Limited)—common shares without par value.

The stock certificates representing the nonexempt shares should in each case be marked with distinguishing legend.

"Surluga Gold Mines Limited—common stock," "Husky Oil Canada Limited—common stock" and "MacDonald Mines Limited — common stock" were deleted from lists previously published in Revenue Ruling 67–196 by Revenue Ruling 67–454, Revenue Ruling 68–135, and Revenue Ruling 68–466. However, if a United States person can establish that his acquisition of shares of common stock of Surluga Gold Mines Limited or Husky Oil Canada Limited are shares which meet the requirements of section 4920(b) of the Code, such an acquisition will not be subject to the interest equalization tax. Interest equalization tax will not be imposed upon United States persons with respect to shares of common stock of MacDonald Mines Limited acquired by them prior to the close of August 19, 1968. Furthermore, for purposes of subsequent acquisitions of common stock of MacDonald Mines Limited (i.e., after August 19, 1968) by other United States persons, any United States person who acquired such stock prior to the close of August 19, 1968, will be considered to have acquired such stock without liability for payment of such tax within the meaning of section 4918(a)(2)(B) of the Code.

Revenue Ruling 67–196, Revenue Ruling 67–454, Revenue Ruling 68–135, and Revenue Ruling 68–466, are hereby superseded.

Subtitle F—Procedure and Administration

Chapter 61—Information and Returns

Subchapter A. Returns and Records

Part I—Records, Statements, and Special Returns

Section 6001.—Notice of Regulations Requiring Records, Statements, and Special Returns

26 CFR 1.6001–1: Records.

Reproduction of certain Federal tax return forms and schedules. See Rev. Proc. 69–17, page 298.

Part II—Tax Returns or Statements

Subpart A—General Requirement

Section 6011.—General Requirement of Return, Statement, or List

26 CFR 1.6011–1: General requirement of return, statement, or list.

Reproduction of certain Federal tax return forms and schedules. See Rev. Proc. 69–17, page 298.

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26 CFR 31.6011(a)–1: Returns under Federal Insurance Contributions Act. (Also 31.6011(a)–3, 31.6011(a)–4.)

A partnership that operates two separate businesses should file only one Form 940 and Form 941 showing the wages paid to the employees of both businesses; S.S.T. 182 superseded.

Rev. Rul. 69–522 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in S.S.T. 182, C.B. 1937–2, 373.

The question presented relates to the returns that a partnership is required to make in reporting the taxes imposed by the Federal Insurance Contributions Act, the tax imposed by 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).

A and *B*, as equal partners, own and operate a lumber business and a clothing business, trading under the name of the A–B Lumber Co. and the A–B Clothing Co., respectively. The partnership has four or more employees throughout the year. The specific question is whether only one return (Form 941, Employer's Quarterly Federal Tax Return, and Form 940, Employer's Annual Federal Unemployment Tax Return) should be filed showing the wages paid to the employees of both the lumber company and the clothing company, or whether each company should be treated as a separate employer and required to file separate returns.

The fact that the partnership carries on different businesses under different trade names does not result in separate partnerships. In the instant case there is only one partnership and it is carrying on two businesses. Accordingly, it is held that separate returns covering each business should not be filed. The wages of all the employees of both businesses should be included in the returns (Forms 940 and 941) required under section 6011 of the Code and the regulations promulgated thereunder.

S.S.T. 182 is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

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26 CFR 31.6011(a)–1: Returns under Federal Insurance Contributions Act.

Returns filed by the fiduciary of a trust or estate. See Rev. Rul. 69–657, page 189.

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26 CFR 31.6011(a)–3: Returns under Federal Unemployment Tax Act.

Responsibility for filing where partnership operates two businesses. See Rev. Rul. 69–522, this page.

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26 CFR 31.6011(a)–3: Returns under Federal Unemployment Tax Act.

Returns filed by the fiduciary of a trust or estate. See Rev. Rul. 69–657, page 189.

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26 CFR 31.6011(a)–4: Returns of income tax withheld from wages.

Responsibility for filing where partnership operates two businesses. See Rev. Rul. 69–522, this page.

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26 CFR 31.6011(a)–4: Return of income tax withheld from wages.

Returns filed by the fiduciary of a trust or estate. See Rev. Rul. 69–657, page 189.

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26 CFR 31.6011(a)–7: Execution of returns.

Requirements and conditions for submission of magnetic tape records in lieu of original information returns. See Rev. Proc. 69–16, page 288.

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26 CFR 31.6011(b)–1: Employers' identification numbers.

Amended regulations relating to the filing of applications for identification numbers with service centers. See T.D. 7012, page 244.

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26 CFR 147.8–1: Interest equalization quarterly tax return.

Amended regulations relating to the place for filing returns and other documents. See T.D. 7012, page 244.

Subpart B—Income Tax Returns

Section 6012.—Persons Required To Make Returns of Income

26 CFR 1.6012–2: Corporations required to make returns of income. (Also Section 818; 1.818–5.)

Number and types of income tax returns to be filed by life insurance companies where, during the calendar year, one company disposes of its insurance business, reserves, and assets, and the other disposes of its business and reserves but retains some assets.

Rev. Rul. 69–405

The Internal Revenue Service has been asked (1) whether, in the situations described below, insurance companies are required to file one or two income tax returns and (2) to specify the type of return to be filed.

Situation 1.—On June 30, a life insurance company disposed of its entire life insurance business and life insurance reserves under a reinsurance agreement with another company, but continued its corporate existence under state law throughout the calendar year for the purpose of winding up and liquidating its affairs. The company neither retained nor acquired assets during the remainder of the calendar year.

Situation 2.—The facts are the same as in *Situation 1* except the company retained some assets during the remainder of the calendar year after disposition of its life insurance business and life insurance reserves.

Section 1.818–5(b) of the Income Tax Regulations provides the rules for life insurance companies in making re-

turns for periods of less than the entire calendar year. It provides that a return for a short period, that is, for a taxable year consisting of a period of less than the entire calendar year, shall be made if the company is not in existence for the entire taxable year. For example, a life insurance company organized on August 1, is required to file a return for the short period from August 1 to December 31, and returns for each calendar year thereafter. Similarly, if a company that qualifies as a life insurance company completely dissolves during the taxable year it is required to file a return for the short period from January 1 to the date *it goes out of existence.*

Section 1.6012–2(a)(2) of the regulations, relating to the requirements for filing income tax returns by corporations, states that after a corporation ceases business and dissolves it may be in existence or not depending upon whether it has any retained assets.

In *Situation 1,* the insurance company disposed of all its life insurance business and life insurance reserves on June 30, but continued its corporate existence under state law for the purpose of winding up and liquidating its affairs. Since the company neither retained assets nor acquired assets after it ceased its insurance business and transferred its activities to another company, a de facto dissolution of the corporation had occurred even though the corporation had not been formally dissolved. Therefore, the corporation was not in existence within the meaning of section 1.6012–2(a)(2) of the regulations and is required to file a short period return on Form 1120L pursuant to section 1.818–5 of the regulations. That would be its one and only return for the year.

In *Situation 2,* on the other hand, since the insurance company retained assets during the remainder of the calendar year after it disposed of its life insurance business and life insurance reserves under the reinsurance agreement, it was in existence at the end of the calendar year, but not as a life insurance company. In that event, it would not have a short taxable year and would not file a short period return. The company would have only one taxable year and would file only one return, Form 1120, for the calendar year. However, for that portion of the calendar year during which it was a life insurance company, it would compute its income under the provisions of subchapter L of the Code. Form 1120L may be used for this purpose as a schedule attached to the company's Form 1120.

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26 CFR 1.6012–2: Corporations required to make returns of income.

A corporation that was operated by a receiver at the beginning of its taxable year and later restored control of the business which it operated for the rest of the year must file an income tax return for the entire taxable year; O.D. 873 superseded.

Rev. Rul. 69–641 [1]

At the beginning of its taxable year a corporation was operated by a receiver having possession of all of its property and control of its business. Later in the year, the receivership was terminated and the property and control of the business was restored to the corporation which continued the business for the rest of the year.

Section 6012 of the Internal Revenue Code of 1954 provides that every corporation subject to income taxes shall file a return with respect to such taxes. Section 1.6012–2 of the Income Tax Regulations provides that a corporation does not go out of existence if it is turned over to a receiver who continues to operate it.

Held, the corporation in the instant case must file an income tax return for the entire year disclosing therein the income, deductions, etc., attributable to the operations for the entire year.

O.D. 873, C.B. 4, 308 (1921), is hereby superseded since the position set forth therein is restated under the current statute and regulations in this Revenue Ruling.

26 CFR 1.6012–3: Returns by fiduciaries.

The income tax return filed on behalf of a corporation by a receiver, who was appointed during the year to take possession and operate the business, should cover the entire taxable year; O.D. 73 superseded.

Rev. Rul. 69–600 [1]

During 1968 a receiver was appointed to take possession of the property and manage the business of a calendar-year corporation. Section 1.6012–2 of the Income Tax Regulations provides that a corporation does not go out of existence if it is turned over to a receiver who continues to operate it. Section 1.6012–3(b)(4) of the regulations provides that a receiver having possession of the property or business of a corporation shall make the return of income for such corporation in the same manner and form as corporations are required to make such returns.

Held, the income tax return filed by the receiver pursuant to section 1.6012–3(b)(4) of the regulations should include the income, deductions, etc., of the entire year's operations.

O.D. 73, C.B. 1, 235 (1919), is hereby superseded since the position set forth therein is restated under the current statute and regulations in this Revenue Ruling.

Subpart C—Estate and Gift Tax Returns

Section 6018.—Estate Tax Returns

26 CFR 20.6018–1: Returns.

Reproduction of certain Federal tax return forms and schedues. See Rev. Proc. 69–17, page 298.

Section 6019.—Gift Tax Returns

26 CFR 25.6019–1: Persons required to file returns.

Reproduction of certain Federal tax return forms and schedules. See Rev. Proc. 69–17, page 298.

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[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

Subpart D—Miscellaneous Provisions

Section 6020.—Returns Prepared for or Executed by Secretary

26 CFR 301.6020–1: Returns prepared or executed by district directors or other internal revenue officers.

Whether the making of a return by the Secretary or his delegate under the authority of section 6020(b)(1) of the Code terminates the period of delinquency for purposes of section 6651. See Rev. Rul. 69–397, page 263.

Part III—Information Returns

Subpart A—Information Concerning Persons Subject to Special Provisions

Section 6031.—Return of Partnership Income

26 CFR 1.6031–1: Return of partnership income.

Amended regulations relating to the filing of returns and other documents with service centers. See T.D. 7012, page 244.

Subpart B—Information Concerning Transactions with Other Persons

Section 6041.—Information at Source

26 CFR 1.6041–1: Return of information as to payments of $600 or more. (Also Sections 6042, 6049; 1.6042–2, 1.6049–1.)

The information return requirements will be met if the surviving corporation in a merger files Forms 1096 and 1099 showing the aggregate amount paid during the calendar year to each payee by both corporations; I.T. 1313, superseded.

Rev. Rul. 69–556 [1]

Two corporations were parties to a merger agreement under which the surviving corporation became the owner of all the assets of the absorbed corporation and assumed all its liabilities. Pursuant to the agreement, the latter corporation was dissolved.

During the premerger portion of the calendar year in which the merger was effected, both corporations made payments of the type subject to information reporting under sections 6041, 6042, and 6049 of the Internal Revenue Code of 1954 and the regulations thereunder. During the postmerger portion of the calendar year, the surviving corporation continued to make such payments.

Held, the information reporting requirements of the specified sections of the Code will be met if the surviving corporation files Forms 1096 and 1099 for payments of both corporations required to be reported. The Forms 1099 should show the aggregate of amounts paid by the corporations to each payee in respect of each type of payment.

I.T. 1313, C.B. I–1, 324 (1922), is hereby superseded, since the position stated therein is restated under current law in this Revenue Ruling.

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

26 CFR 1.6041–1: Return of information as to payments of $600 or more. (Also Section 7805; 301.7805–1.)

Payments made on or after January 1, 1969, directly to doctors or other suppliers of services under health-care plans in the course of the trade or business of persons making the payments are reportable on information returns.

Rev. Rul. 69–595 [1]

Advice has been requested whether payments made to suppliers of services under health, accident, and sickness insurance plans or medical assistance programs are required to be reported on information returns, Forms 1099 and 1096, under the provisions of Section 6041 of the Internal Revenue Code of 1954 and the regulations thereunder.

Those making payments include insurance companies (including those participating in Medicare), Blue Cross-Blue Shield organizations, State agencies participating in the Medicaid program (Title XIX of the Social Security Act), and unions and employers having self-insured or self-administered plans.

Medicaid is a State-administered assistance program providing medical care for the needy, under which payments are generally made by a single State agency administering the program or its fiscal agent directly to the supplier.

Generally, health, accident, and sickness insurance policies provide that the amounts payable thereunder are payable to the insured unless the insured assigns his rights to receive payments to those persons who supplied the medical services. In many cases the insured assigns his rights to receive payment to the doctor and payment is made directly to the doctor.

Section 6041(a) of the Code provides, in part, that all persons engaged in a trade or business and making payment in the course of such trade or business to another person, of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income, of $600 or more in any taxable year, shall render a true and accurate return to the Secretary of the Treasury or his delegate, under such regulations and in such form and manner and to such extent as may be prescribed by the Secretary or his delegate, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment.

Section 1.6041–1(a) of the Income Tax Regulations provides that the return required by section 6041(a) must be made on Forms 1099 and 1096, and a separate Form 1099 shall be furnished for each person to whom such payments of $600 or more are made. Section 1.6041–1(b) of the regulations provides that the term "all persons engaged in a trade or business," as used in section 6041(a) includes not only those so engaged for gain or profit, but also organizations the activities of which are not for the purpose of gain or profit. See also Rev. Rul. 56–176, C.B. 1956–1, 560.

Section 1.6041–3 of the regulations provides that returns of information

[1] Also released as Technical Information Release 1023, dated Nov. 13, 1969.

are not required with respect to payments of any type made to corporations.

Payments of fees under the plans, programs, or policies here considered to doctors or other suppliers of health care services are made in the course of the trade or business of the persons making the payment. Accordingly, it is held that such persons are required to file Forms 1099 with respect to such payments made directly to doctors or other suppliers. A separate Form 1099 must be furnished by each payer for each doctor or other supplier to whom it makes payments aggregating $600 or more during any calendar year. Pursuant to section 1.6041–3 of the regulations payments to corporations are excepted from the information reporting requirements of section 6041 of the Code.

Under the authority of Section 7805(b) of the Code, this ruling will be applied only to payments made in calendar years beginning on and after January 1, 1969. Since most of 1969 has passed, the Service recognizes that some payers will have problems in establishing accounting systems or procedures for retrieving and reporting information with respect to amounts paid during 1969. Payers making payments under Medicare and Medicaid programs whose accounting systems and procedures are not geared to retrieving and reporting this information for 1969 will not be required to file information returns for 1969 provided they file such returns with respect to payments made on and after January 1, 1970. Furthermore, except for payments made under Medicare and Medicaid programs, the provisions of this Revenue Ruling will not be applied with respect to payments made prior to January 1, 1971.

The Service would prefer that the returns required by this Revenue Ruling be filed in magnetic tape form. The procedural requirements and specifications for magnetic tape reporting are set forth in Rev. Proc. 69–16, page 288, this Bulletin. Whether filed on paper, Form 1099, or on magnetic tape, the returns should be forwarded on or before the due date (for example, March 2, 1970 with respect to calendar year 1969 returns) for filing to any of the following addresses:

Southeast Region, P.O. Box 47–421, Doraville, Ga., 30340
Midwest Region, P.O. Box 5321, Kansas City, Mo., 64131
Central Region, P.O. Box 267, Covington, Ky., 41012
Southwest Region, P.O. Box 934, Austin, Tex., 78767
North-Atlantic Region, P.O. Box 311, Andover, Mass., 01810
Mid-Atlantic Region, P.O. Box 279, Cornwells Heights, Pa., 19020
Western Region, P.O. Box 388, Ogden, Utah, 84401

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26 CFR 1.6041–1: Return of information as to payments of $600 or more.

The information return requirements will be met if the executor of an estate files Forms 1096 and 1099 showing the aggregate of reportable payments made to noncorporate payees by the decedent and the estate; I.T. 1631 superseded.

Rev. Rul. 69–601 [1]

During the calendar year a business was operated by an individual until the date of his death and by the executor of his estate for the rest of the year. Both the individual and the executor made payments of the type subject to information reporting under section 6041 of the Internal Revenue Code of 1954 and the regulations thereunder (fees, rents, etc., of $600 or more to noncorporate payees).

Held, the information reporting requirements of section 6041 of the Code will be met if the executor files an information return on Forms 1096 and 1099 for reportable payments of both the individual and the estate. Where a particular payee has received payments from both payers, the Form 1099 should show the aggregate of amounts paid.

[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

I.T. 1631, C.B. II–1, 182 (1923), is hereby superseded since the position set forth therein is restated under the current statute and regulations in this Revenue Ruling.

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26 CFR 1.6041–1: Return of information as to payments of $600 or more.

Requirements and conditions for submission of magnetic tape records in lieu of original information returns. See Rev. Proc. 69–16, page 288.

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26 CFR 1.6041–4: Returns of information as to foreign items.
(Also Section 7001; 301.7001–1.)

A domestic corporation acting as nominee of a domestic bank's customers need not file information returns for interest and dividends collected on foreign securities nor obtain a license to collect foreign items where the bank is licensed and files the necessary returns.

Rev. Rul. 69–439

Advice has been requested as to the information reporting and licensing requirements applicable to a corporation organized to act as nominee of customers of a domestic bank under the circumstances described below.

The domestic bank is agent for certain customers with regard to the purchase, ownership, and sale of the securities of foreign corporations and the collection of dividends and interest from the foreign corporations. In order to overcome practical problems caused by the legal requirements of certain foreign countries regarding nominee ownership, the bank organized a domestic corporation to act as the nominee of the customers of the bank desiring to invest in securities in these countries.

The corporation derives no income as nominee and the bank bears all expenses incurred by the corporation. The collection functions are performed by employees of the bank. The bank maintains appropriate records concerning the items collected on the securities held by the corporation as nominee.

The bank makes the information returns required by section 6041(b) of the Internal Revenue Code of 1954 and has obtained the license required by section 7001 of the Code. In the information returns filed by the bank it reports all foreign items collected on the securities held by the corporation as nominee.

Section 6041(b) of the Code provides, in relevant part, that a person collecting as a matter of business or for profit, interest or dividends from foreign corporations shall make a return setting forth the amount paid and the name and address of the recipient of each such payment.

Section 7001 of the Code provides that a person undertaking as a matter of business or for profit the collection of foreign payments of interest or dividends shall obtain a license from the Secretary of the Treasury or his delegate.

Under the circumstances described, the requirements of sections 6041(b) and 7001 of the Code are satisfied when the bank made the information returns on which it reported all foreign items collected on the securities held by the corporation as nominee and obtained a license.

Accordingly, the domestic corporation need not file information returns with respect to the interest or dividends collected on such securities nor obtain a license to collect foreign items.

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26 CFR 1.6041–5: Information as to actual owner.

Requirements and conditions for submission of magnetic tape records in lieu of original information returns. See Rev. Proc. 69–16, page 288.

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.

Whether a single Form 1099 may be filed for each payee by the surviving corporation in a merger reporting the aggregate amount of the dividends paid by both the surviving corporation and the absorbed corporation. See Rev. Rul. 69–556, page 242.

26 CFR 1.6042–2: Returns of information as to dividends paid in calendar years after 1962.

Requirements and conditions for submission of magnetic tape records in lieu of original information returns. See Rev. Proc. 69–16, page 288.

Section 6049.—Returns Regarding Payments of Interest

26 CFR 1.6049–1: Returns of information as to interest paid in calendar years after 1962.

Whether a single Form 1099 may be filed for each payee by the surviving corporation in a merger reporting the aggregate amount of the interest paid by both the surviving corporation and the absorbed corporation. See Rev. Rul. 69–556, page 242.

Subpart C—Information Regarding Wages Paid Employees

Section 6051.—Receipts for Employees

26 CFR 31.6051–1: Statement for employees.

Requirements and conditions for submission of magnetic tape records in lieu of original information returns. See Rev. Proc. 69–16, page 288.

Part VII—Place for Filing Returns or Other Documents

Section 6091.—Place for Filing Returns or Other Documents

26 CFR 25.6091: Statutory provisions; place for filing returns or other documents.
(Also 301.6091–1.)
(Also Sections 3121, 6011, 6031, 6109; 36.3121(1)(1)–1, 31.6011(b)–1, 147.8–1, 1.6031–1, 41.6109–1, 45.6109–1, 46.6109–1, 48.6109–1, 49.6109–1, 151.30, 152.28.)

T.D. 7012 [1]

Title 26.—Internal Revenue.—Chapter 1, Subchapter A, Part 1.—Income Tax; Taxable Years Beginning After December 31, 1953; Subchapter B, Part 25.—Gift Tax; Gifts Made After December 31, 1954; Subchapter C, Part 31.—Employment Taxes; Applicable on and After January 1, 1955; Part 36.—Contract Coverage of employees of Foreign Subsidiaries; Subchapter D, Part 41.—Excise Tax on use of Certain Highway Motor Vehicles; Part 45.—Miscellaneous Stamp Taxes; Part 46.—Regulations Relating to Miscellaneous Excise Taxes Payable by return; Part 48.—Manufacturers and retailers Excise Taxes; Part 49.—Facilities and Services Excise Taxes; Part 147.—Temporary regulations Under the Interest Equalization Tax Act; Part 151.—Regulatory Taxes on Narcotic Drugs; Part 152.—Regulatory Taxes on Marihuana; Subchapter F, Part 301.—Procedure and Administration.

Filing of certain miscellaneous returns and documents with service centers.

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 March 11, 1969, notice of proposed rule making was published in the Federal Register (34 F.R. 5067) in order to revise the rules for the filing of certain returns and other documents with service centers and to conform certain provisions of the regulations (26 CFR Parts 1, 25, 31, 36, 41, 45, 46, 48, 49, 147, 151, 152, 301) to the amendments made by section 1 of the Act of November 2, 1966 (Pub. Law 89–713, 80 Stat. 1108) [C.B. 1966–2, 617]. After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted:

Subchapter A—Income Tax

Part 1—Income Tax; Taxable Years Beginning After December 31, 1953

PARAGRAPH 1. Subdivisions (iv) (*a*) and (v) (*a*) (2) of paragraph (a) (2) of § 1.761–1 are amended to read as follows:

§ 1.761–1 Terms defined.

(a) *Partnership.* * * *

(2) *Exclusion of certain partnerships from provisions of subchapter K.* * * *

(iv) *Method of election—(a) Complete exclusion from subchapter K.* Any unincorporated organization described in subdivisions (i) and (ii) or (iii) of this subparagraph which wishes to be excluded from all of subchapter K

[1] 34 F.R. 7687.

must make the election provided in section 761(a) in a statement attached to a properly executed partnership return, Form 1065, which shall contain the information required in this subdivision. Such return shall be filed with the internal revenue officer with whom a partnership return, Form 1065, would be required to be filed if no election were made. Where, for the purpose of determining the proper internal revenue officer with whom Form 1065 must be filed, it is necessary to determine the internal revenue district (or service center serving such district) in which the electing organization has its principal office or place of business, the principal office or place of business of the operator shall be considered the principal office or place of business of the organization, unless the person filing for the organization is not the operator, in which case, the principal office or place of business of the person filing the return shall be considered the principal office or place of business of the organization. For the first year with respect to which such unincorporated organization wishes to be excluded from subchapter K, its partnership return shall contain, in lieu of the information required by Form 1065 and by the instructions relating thereto, only the name or other identification and the address of the organization. The statement attached to the return shall include the names and addresses of all the members of the organization; a statement that the orgnization qualifies under subdivisions (i) and either (ii) or (iii) of this subparagraph, a statement that all of the members of the organization elect that it be excluded from all of subchapter K; and a statement indicating where a copy of the agreement under which the organization operates is available (or if the agreement is oral, from whom the provisions of the agreement may be obtained). Unless within 90 days after the formation of the organization (or by October 15, 1956, whichever is later) any member of the organization notifies the Commissioner that the member desires subchapter K to apply to such organization, and also advises the Commissioner that he has so notified all other members of the organization by registered or certified mail, the election to be excluded will be effective. Such election is irrevocable as long as the organization remains qualified under subdivisions (i) and either (ii) or (iii) of this subparagraph, or unless approval of revocation of the election is secured from the Commissioner. Application for permission to revoke the election must be submitted to the Commissioner of Internal Revenue, Attention: T:I Washington, D.C. 20224, no later than 30 days after the beginning of the first taxable year to which the revocation is to apply. An unincorporated organization need not file an election to be excluded under section 761 for the first year of its existence but may do so at the time of filing the return for any taxable year for which exclusion from subchapter K is desired. Such unincorporated organization shall file a partnership return for the first taxable year in which the participants by a formal agreement undertake to engage in joint operations, or in the absence of a formal agreement for the first taxable year in which the participants with respect to the joint use of property jointly make or incur any expenditures treated as deductions for Federal income tax purposes, whether or not electing to be excluded from the provisions of subchapter K. Where no annual accounting period has been adopted by such unincorporated organization, its taxable year shall be the calendar year in accordance with section 441(g).

* * * * *

(v) *Information to be filed by organizations excluded under section 761(a)* * * *

(2) For each subsequent taxable year for which it is excluded: Form 1096 for the organization and a Form 1099 for each person who was a member of the organization during any part of the calendar year. Form 1099 shall show the name and address of the organization (under "By Whom Paid"). In lieu of "Kind and Amount of Income Paid", each Form 1099 shall state "Filed under section 761(a)" and the principal activity of the organization. Forms 1096 and 1099 shall be filed with the internal revenue officer designated in instructions applicable to such forms.

* * * * *

PAR. 2. Paragraph (a) of § 1.852–9 is amended by revising subparagraphs (2)(i) and (3) to read as follows:

§ 1.852–9 Special procedural requirements applicable to designation under section 852(b)(3)(D).

(a) *Regulated investment company.* * * *

(2) *Return of undistributed capital gains tax*—(i) *Form 2438.* Every regulated investment company which designates undistributed capital gains for any taxable year beginning after December 31, 1956, in accordance with subparagraph (1) of this paragraph shall file for such taxable year an undistributed capital gains tax return on Form 2438 including on such return the total of its undistributed capital gains so designated and the tax with respect thereto. The return on Form 2438 shall be prepared in duplicate and shall set forth fully and clearly the information required to be included therein. The original of Form 2438 shall be filed on or before the 30th day after the close of the company's taxable year with the internal revenue officer designated in instructions applicable to Form 2438. The duplicate copy of Form 2438 for the taxable year shall be attached to and filed with the income tax return of the company on Form 1120 for such taxable year.

* * * * *

(3) *Payment of tax.* The tax required to be returned on Form 2438 shall be paid by the regulated investment company on or before the 30th day after the close of the company's taxable year to the internal revenue officer with whom the return on Form 2438 is filed.

PAR. 3. Paragraph (a) of § 1.1372–2 is amended to read as follows:

§ 1.1372–2 Manner and time for making election and filing shareholders' consent.

(a) *Manner of making election.* The election of a small business corporation should be made by the corporation by filing Form 2553, containing the information required by such form, and by filing, in the manner provided in § 1.1372–3, a statement of the consent of each shareholder of the corporation. The election form shall be signed by any person who is authorized to sign the return required under section 6037 and shall be filed with the internal revenue officer designated in the instructions applicable to Form 2553.

* * * * *

PAR. 4. Section 1.1372–3 is amended to read as follows:

§ 1.1372–3 Shareholders' consent.

(a) *In general.* The consent of a shareholder to an election by a small business corporation shall be in the form of a statement signed by the shareholder in which such shareholder consents to the election of the corporation. Such shareholder's consent in binding and may not be withdrawn after a valid election is made by the corporation. Each person who is a shareholder of the electing corporation must consent to the election; thus, where stock of the corporation is owned by a husband and wife as community property (or the income from which is community property), or is owned by tenants in common, joint tenants, or tenants by the entirety, each person having a community interest in such stock and each tenant in common, joint tenant, and tenant by the entirety must consent to the election. The consent of a minor shall be made by the minor or by his legal guardian, or his natural guardian if no legal guardian has been appointed. The consent of an estate shall be made by the executor or administrator thereof. The statement shall set forth the name and address of the corporation and of the shareholder, the number of shares of stock owned by him, and the date (or dates) on which such stock was acquired. The consents of all shareholders may be incoporated in one statement. The consents of all persons who are shareholders at the time the election is made shall be attached to the election of the corporation. If the election is made before the first day of the corporation's taxable year for which it is effective, the consents of persons who become shareholders after the date of election and are shareholders on such first day shall be filed with the internal revenue officer with whom the election was filed as soon as practicable after such first day. The consent referred to in the preceding sentence will be considered timely if it is filed on or before the last day prescribed for making the election. Where a consent is filed after the date of election, a copy of the consent shall also be filed with the return required to be filed under section 6037. In the case of a shareholder in a community-property State whose spouse has filed a timely consent to an election under section 1372(a) for a taxable year beginning before January 1, 1961, the time for filing the consent of such shareholder shall not expire prior to May 15, 1961; in the case of a shareholder in a community-property State whose spouse has filed a timely consent to an election under section 1372(a) for a taxable year beginning after December 31, 1960, and on or before October 26, 1962, the consent of such shareholder shall be considered timely if it is filed on or before the last day prescribed for making the election. An election under section 1372(a) will not be valid if any of the consents are not timely filed. However, see paragraph (c) of this section for extension of time for filing consents. In addition, an election which was timely filed for any taxable year beginning before March 1, 1960, and which would be valid but for the fact that the consent of any shareholder of the corporation was not filed or was defective in any manner, will not be invalid if—

(1) A proper consent is filed by such shareholder after December 19, 1959, and on or before March 1, 1960.

(2) All shareholders of the corporation who previously filed timely and proper consents file new consents within the period mentioned in subparagraph (1) of this paragraph, and

(3) The shareholders show to the satisfaction of the district director with whom the election under section 1372(a) was filed that the failure to file timely and proper consents was not due to an intention to avoid making a valid election.

(b) *New shareholders.* If a person becomes a shareholder of an electing small business corporation after the first day of the taxable year for which the election is effective, or after the day on which the election is made (if such day is later than the first day of the taxable year), the consent of such shareholder shall be made in a statement filed (with the internal revenue officer with whom the election is filed) within the period of 30 days beginning with the day on which such person becomes a new shareholder. A copy of such consent should be furnished to the corporation by the new shareholder. If the new shareholder is an estate, the 30-day period shall not begin until the executor or administrator has qualified under local law to perform his duties, but in no event shall such period begin later than 30 days following the close of the corporation's taxable year in which the estate became a shareholder. The statement of consent shall set forth the name and address of the corporation and of such new shareholder, the number of shares of stock owned by such shareholder, the date on which such shares were acquired, and the name and address of each person from whom such shares were acquired. A copy of the consent of such new shareholder shall be filed with the return required to be filed under section 6037 for the taxable year to which such consent applies. For the effect of the failure of a new share-

holder to consent, see paragraph (b)(1) of § 1.1372–4.

(c) *Extension of time for filing consents.* An election which is timely filed for any taxable year and which would be valid, or would not have terminated, except for the failure of any shareholder to file a consent within the time prescribed in paragraph (a) or (b) of this section will not be invalid, or will not be treated as having terminated, for such reason if—

(1) It is shown to the satisfaction of the district director or director of the service center that there was reasonable cause for the failure to file such consent and that the interests of the Government will not be jeopardized by treating such election as valid, or as not having terminated.

(2) Such shareholder files a proper consent to the election within such extended period of time as may be granted by the Internal Revenue Service, and

(3) New consents are filed within such extended period of time as may be granted by the Internal Revenue Service, by all persons who were shareholders of the corporation at any time during the taxable year with respect to which the failure to consent would (but for the provisions of this paragraph) cause the corporation's election to be invalid or to terminate, and by all persons who were shareholders of the corporation subsequent to such taxable year and prior to the date on which an extension of time is granted in accordance with this paragraph.

PAR. 5. Paragraph (b) of § 1.1372–4 is amended by revising subparagraphs (2) and (3). The revised provisions read as follows:

§ 1.1372–4 Termination of election.

* * * * *

(b) *Method of termination.* * * *

(2) *Revocation.* An election under section 1372(a) may be revoked by the corporation for any taxable year of the corporation after the first taxable year for which the election is effective. A revocation can be made only with the consent of all the persons who are shareholders at the beginning of the day of revocation. Such revocation shall be made by the corporation by filing a statement that the corporation revokes the election made under section 1372(a), which statement shall indicate the first taxable year of the corporation for which the revocation is intended to be effective. The statement shall be signed by any person authorized to sign the return of the corporation under section 6037 and shall be filed with the internal revenue officer with whom the election was filed. In addition, there shall be attached to the statement of revocation a statement of consent, signed by each person who is a shareholder of the corporation at the beginning of the day on which such statement of revocation is filed, in which each such shareholder consents to the revocation by the corporation of the election under section 1372(a). For the time within which a revocation must be made to be effective for a particular taxable year of the corporation, see paragraph (c) of this section.

(3) *Ceases to be small business corporation.* An election under section 1372(a) terminates if at any time after the first day of the first taxable year of the corporation for which the election is effective, or after the day on which the election is made (if such day is later than the first day of the taxable year), the corporation ceases to be a small business corporation as defined in section 1371(a). Thus, the election is terminated if an 11th person, a nonresident alien, or a trust, partnership, or corporation becomes a shareholder, or if another class of stock is issued by the corporation. In the event of a termination under this subparagraph the corporation shall immediately notify the internal revenue officer with whom the election under section 1372(a) was filed. Such notification shall set forth the cause of the termination and the date thereof. In addition, if the termination was caused by the transfer of stock to an 11th shareholder, to a nonresident alien, or to a trust, partnership, or corporation, the notification shall specify the number of shares transferred to such person, the name of such person (or in the case of a trust the names of the trustees and beneficiaries), and the name of the shareholder who transferred such stock to such person. If the termination was caused by the issuance of a second class of stock, the notification shall indicate the number of shares of such new class issued and shall describe the differentiating characteristics of the new class of stock.

* * * * *

PAR. 6. Paragraphs (a) and (c) of § 1.1375–3 are amended to read as follows:

§ 1.1375–3 Treatment of family groups.

(a) *In general.* Pursuant to section 1375(c), any dividend received by a shareholder from an electing small business corporation (including any amount treated as a dividend under section 1373(b)) may be apportioned or allocated by the Internal Revenue Service between or among shareholders of such corporation who are members of such shareholder's family, if it determines that such apportionment or allocation is necessary in order to reflect the value of services rendered to the corporation by such shareholders. In determining the value of services rendered by a shareholder, consideration shall be given to all the facts and circumstances of the business, including the managerial responsibilities of the shareholder, and the amount that would ordinarily be paid in order to obtain comparable services from a person not having an interest in the corporation. The taxable income of the corporation shall be neither increased nor decreased because of the reallocation of dividends under section 1375(c). The amount reallocated shall be considered a dividend to the shareholder to whom it is reallocated.

* * * * *

(c) *Example.* The provisions of section 1375(c) may be illustrated by the following example:

Example. The stock of an electing small business corporation is owned 50 percent by F and 50 percent by S, a minor son of F. For the taxable year, the corporation has $70,000 of taxable income and earnings and profits. During the year, the corporation distributes dividends (including amounts treated as dividends under section 1373(b)) of $35,000 to F and $35,000 to S. Compensation of $10,000 is paid by the corporation to F for services rendered during the year, and no compensation is paid to S, who rendered no services. Based on the relevant facts, a reasonable compensation for the services rendered by F would be $30,000. In the discretion of the Internal Revenue Service, up to $10,000 of the $35,000 dividend received by S may, for tax purposes, be allocated to F.

* * * * *

PAR. 7. Paragraphs (d)(2) and (e)(1) of § 1.6031–1 are amended to read as follows:

§ 1.6031–1 Return of partnership income.

* * * * *

(d) *Partnerships having no United States business.* * * *

(2) *Returns of information with respect to partnership required of citizen or resident partners.* Where a U.S. citizens or resident is a partner in a parternship described in subparagraph (1) of this paragraph which is not required to file a partnership return, the district director or director of the service center may require such person to render such statements or provide such information as is necessary to show whether or not such person is liable for tax on income derived from such partnership. In addition, if an election in accordance with the provisions of section 703 (relating to elections affecting the computation of taxable income derived from a partnership) or section 761 (relating to the election to be excluded from the application of all or part of subchapter K, chapter 1 of the Code) is to be made by or for the partnership, a return on Form 1065 shall be filed for such partnership. See section 6063 and § 1.6063–1, relating to the authority of a partnership to sign a partnership return. The filing of one such return for a taxable year of the partnership by a citizen or resident partner shall constitute a filing for the partnership of such partnership return.

(e) *Place and time for filing returns*—(1) *Place for filing*—(i) *Returns filed with district director or Director of International Operations.* The returns of partnerships doing business, or having income from sources, within the United States shall be filed with the district director for the internal revenue district in which the partnership has its principal office or principal place of business within the United States. If a partnership has no office, place of business, or agency within the United States, the return shall be filed with the Director of International Operations, Internal Revenue Service, Washington, D.C. 20225. A partnership return filed under the authority of paragraph (d)(2) of this section shall be filed with the internal revenue officer with whom the citizen or resident partner files his separate income tax return.

(ii) *Returns filed with service centers.* Notwithstanding subdivision (i) of this subparagraph, unless a return is filed by hand carrying, whenever instructions applicable to partnership returns provide that the return be filed with a service center, the return must be so filed in accordance with the instructions. Returns which are filed by hand carrying shall be filed with the district director in accordance with subdivision (i) of this subparagraph.

* * * * *

PAR. 8. Paragraph (c) of § 1.6034–1 is amended to read as follows:

§ 1.6034–1 Information returns required of certain trusts claiming charitable or other deductions under section 642(c).

* * * * *

(c) *Time and place for filing return.* The return on Form 1041–A shall be filed on or before the 15th day of the fourth month following the close of the taxable year of the trust, with the internal revenue officer designated by the instructions applicable to such form.

* * * * *

PAR. 9. Paragraph (b) of § 1.6037–1 is amended to read as follows:

§ 1.6037–1 Return of electing small business corporation.

* * * * *

(b) *Time and place for filing return.* The return shall be filed on or before the 15th day of the third month following the close of the taxable year with the internal revenue officer designated in the instructions applicable to Form 1120–S. (See section 6072.)

* * * * *

PAR. 10. Section 1.6091–2 is amended by adding a cross reference at the end of paragraph (d) thereof:

§ 1.6091–2 Place for filing income tax returns.

* * * * *

(d) *Hand-carried returns.* Notwithstanding paragraphs (1) and (2) of section 6091(b) and paragraph (c) of this section—

(1) *Persons other than corporations.* Returns of persons other than corporations which are filed by hand carrying shall be filed with the district director as provided in paragraph (a) of this section.

(2) *Corporations.* Returns of corporations which are filed by hand carrying shall be filed with the district director as provided in paragraph (b) of this section.

See § 301.6091–1 of this chapter (Regulations on Procedure and Administration) for provisions relating to the definition of hand carried.

* * * * *

PAR. 11. Section 1.6091–3 is amended by revising paragraphs (b) and (i) to read as follows:

§ 1.6091–3 Income tax returns required to be filed with Director of International Operations.

* * * * *

(b) Income tax returns on an individual citizen of the United States whose principal place of abode for the period with respect to which the return is filed is outside the United States. A taxpayer's principal place of abode will be considered to be outside the United States if his legal residence is outside the United States or if his return bears a foreign address.

* * * * *

(i) Income tax returns of corporations which claim the benefits of section 922 (relating to special deduction for Western Hemisphere trade corporations) except in the case of consolidated returns filed pursuant to the regulations under section 1502.

* * * * *

PAR. 12. Paragraph (c)(3) of § 1.6109–1 is amended to read as follows:

§ 1.6109–1 Identifying numbers.

* * * * *

(c) *Applications.* * * *

(3) *Employer identification number.* Application for an employer identification number shall be made on Form SS–4. Form SS–4 will generally be furnished only on request and may be obtained from any district director or director of a service center, or any district office of the Social Security Administration. The application, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. The application shall be signed by (i) the individual, if the person is an individual; (ii) the president, vice president, or other principal officer, if the person is a corporation; (iii) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (iv) the fiduciary, if the person is a trust or estate. The application for an employer identification number should be filed approximately 1 month in advance of the first required use of the number to permit issuance of the number in time for compliance with such requirement. The application shall be filed with the internal revenue officer designated in the instructions applicable to Form SS–4. An employer identification number will be assigned to the applicant in due course upon the basis of information reported on the application.

* * * * *

Subchapter B—Estate and Gift Taxes

Part 25—Gift Tax; Gifts Made After December 31, 1954

PAR. 13. Section 25.2513–3 is amended to read as follows:

§ 25.2513–3 Revocation of consent.

If the consent to the application of the provisions of section 2513 for a calendar year was effectively signified on or before the 15th day of April following the close of the calendar year, either spouse may revoke the consent by filing in duplicate a signed statement of revocation, but only if the statement is filed on or before such 15th day of April. Except as provided in paragraph (b) of § 301.6091–1 (relating to hand-carried documents), the statement shall be filed with the internal revenue officer with whom the gift tax return is required to be filed, or with whom the gift tax return would be required to be filed if a return were required. Therefore, a consent which was not effectively signified until after the 15th day of April following the close of the calendar year to which it applies may not be revoked.

PAR. 14. Paragraph (c) of § 25.2522(a)–1 is amended to read as follows:

§ 25.2522(a)–1 Charitable and similar gifts; citizens or residents.

* * * * *

(c) In order to prove the right to the charitable, etc., deduction provided by section 2522 the donor must submit such data as may be requested by the Internal Revenue Service. As to the extent the deductions provided by this section are allowable, see section 2524.

PAR. 15. Paragraph (a) of § 25.2523(a)–1 is amended to read as follows:

§ 25.2523(a)–1 Gift to spouse; in general.

(a) *In general.* In determining the amount of taxable gifts for the calendar year 1955 or any calendar year thereafter, in the case of a donor who was a citizen or resident of the United States at the time the gift was made, there may be deducted an amount equal to one-half the value of any property interest (except as otherwise provided in paragraph (b) of this section) transferred by gift to a donee who at the time of the gift was the donor's spouse. This deduction is referred to as the "marital deduction." No marital deduction is authorized with respect to a gift if the donor, at the time of the gift, was a nonresident not a citizen of the United States. However, if the donor was a citizen or resident of the United States at the time the gift was made, he is not deprived of the right to the marital deduction by reason of the fact that his spouse was a nonresident not a citizen. For convenience the donor's spouse is generally referred to in the feminine gender, but if the donor is a woman the reference is to her husband. The donor must submit such proof as is necessary to establish the right to the marital deduction, including any evidence requested by the Internal Revenue Service.

* * * * *

PAR. 16. Paragraph (b) of § 25.6001–1 is amended to read as follows:

§ 25.6001–1 Records required to be kept.

* * * * *

(b) *Supplemental data.* In order that the Internal Revenue Service may determine the correct tax the donor shall furnish such supplemental data

as may be deemed necessary by the Internal Revenue Service. It is, therefore, the duty of the donor to furnish, upon request, copies of all documents relating to his gift or gifts, appraisal lists of any items included in the total amount of gifts, copies of balance sheets or other financial statements obtainable by him relating to the value of stock constituting the gift, and any other information obtainable by him that may be necessary in the determination of the tax. See section 2512 and the regulations issued thereunder. For every policy of life insurance listed on the return, the donor must procure a statement from the insurance company on Form 938 and file it with the internal revenue officer with whom the return is filed. If specifically requested by an internal revenue officer, the insurance company shall file this statement direct with the internal revenue officer.

PAR. 17. Paragraph (b) of § 25.6011–1 is amended to read as follows:

§ 25.6011–1 General requirement of return, statement, or list.

* * * * *

(b) *Use of prescribed forms.* Copies of the forms prescribed by paragraph (b) of § 25.6001–1 and § 25.6019–1 may be obtained from district directors and directors of service centers. The fact that a person required to file a form has not been furnished with copies of a form will not excuse him from the making of a gift tax return, or from the furnishing of the evidence for which the forms are to be used. Application for a form should be made to the district director or director of a service center in ample time to enable the person whose duty it is to file the form to have the form prepared, verified, and filed on or before the date prescribed for the filing thereof.

PAR. 18. Paragraph (c) of § 25.6019–1 is amended to read as follows:

§ 25.6019–1 Persons required to file returns.

* * * * *

(c) *Ratification of return.* The return shall not be made by an agent unless by reason of illness, absence, or nonresidence, the person liable for the return is unable to make it within the time prescribed. Mere convenience is not sufficient reason for authorizing an agent to make the return. If by reason of illness, absence or nonresidence, a return is made by an agent, the return must be ratified by the donor or other person liable for its filing within a reasonable time after such person becomes able to do so. If the return filed by the agent is not so ratified, it will not be considered the return required by the statute. Supplemental data may be submitted at the time of ratification. The ratification may be in the form of a statement, executed under the penalties of perjury and filed with the internal revenue officer with whom the return was filed, showing specifically that the return made by the agent has been carefully examined and that the person signing ratifies the return as the donor's. If a return is signed by an agent, a statement fully explaining the inability of the donor must accompany the return.

PAR. 19. Paragraph (b) of § 25.6019–3 is amended to read as follows:

§ 25.6019–3 Contents of return.

* * * * *

(b) *Disclosure of transfers coming within provisions of section 2516.* Section 2516 provides that certain transfers of property pursuant to written property settlements between husband and wife are deemed to be transfers for full and adequate consideration in money or money's worth if divorce occurs within 2 years. In any case where a husband and wife enter into a written agreement of the type contemplated by section 2516, and the final decree of divorce is not granted on or before the due date for the filing of a gift tax return for the calendar year in which the agreement became effective (see § 25.6075–1), the transfer shall be disclosed by the transferor upon a gift tax return filed for the calendar year in which the agreement became effective and a copy of the agreement shall be attached to the return. In addition, a certified copy of the final divorce decree shall be furnished the internal revenue officer with whom the return was filed not later than 60 days after the divorce is granted. Pending receipt of evidence that the final decree of divorce has been granted (but in no event for a period of more than 2 years from the effective date of the agreement), the transfer will tentatively be treated as made for a full and adequate consideration in money or money's worth.

PAR. 20. Section 25.6075–1 is amended to read as follows:

§ 25.6075–1 Returns; time for filing gift tax returns.

The gift tax return required by section 6019 must be filed on or before the due date. The due date is the date on or before which the return is required to be filed in accordance with the provisions of section 6075(b) or the last day of the period covered by an extension of time granted, as provided in § 25.6081–1. Unless an extension of time has been granted, the due date is the 15th day of April following the close of the calendar year in which gifts were made. When the due date falls on Saturday, Sunday, or a legal holiday, the due date for filing the return is the next succeeding day which is not Saturday, Sunday, or a legal holiday. For definition of a legal holiday, see section 7503 and § 301.7503–1 of this chapter (Regulations on Procedure and Administration). As to additions to the tax for failure to file the return within the prescribed time, see section 6651 and § 301.6651–1 of this chapter (Regulations on Procedure and Administration).

PAR. 21. Section 25.6081–1 is amended to read as follows:

§ 25.6081–1 Extension of time for filing returns.

It is important that the donor file on or before the due date a return as nearly complete and final as it is possible for him to prepare. However, the district director or director of the serv-

ice center is authorized to grant a reasonable extension of time for filing returns. Applications for extensions of time for filing gift tax returns must contain a full recital of the causes for delay. Except as provided in paragraph (b) of § 301.6091–1 (relating to hand-carried documents), such application shall be made to the internal revenue officer with whom such return is required to be filed. Except in the case of donors who are abroad, no extension for filing gift tax returns may be granted for more than 6 months. An extension of time for filing a return does not operate to extend the time for payment of the tax or any part thereof, unless so specified in the extension. For extensions of time for payment of tax, see § 25.6161–1. No extension of time for filing a return may be granted unless the application is received by such internal revenue officer before the expiration of the time within which the return must otherwise be filed. The application should, when possible, be made sufficiently early to permit the internal revenue officer to consider the matter and reply before what otherwise would be the due date of the return.

PAR. 22. Section 25.6091 is amended by revising section 6091(b) and adding a historical note to read as follows:

§ 25.6091 Statutory provisions; place for filing returns or other documents.

SEC. 6091. *Place for filing returns or other documents*— * * *

(b) *Tax returns.* In the case of returns of tax required under authority of part II of this subchapter

(1) *Persons other than corporations*—(A) *General rule.* Except as provided in subparagraph (B), a return (other than a corporation return) shall be made to the Secretary or his delegate—

(i) In the internal revenue district in which is located the legal residence or principal place of business of the person making the return, or

(ii) At a service center serving the internal revenue district referred to in clause (i),

as the Secretary or his delegate may by regulations designate.

(B) *Exception.* Returns of—

(i) Persons who have no legal residence or principal place of business in any internal revenue district,

(ii) Citizens of the United States whose principal place of abode for the period with respect to which the return is filed is outside the United States,

(iii) Persons who claim the benefits of section 911 (relating to earned income from sources without the United States), section 931 (relating to income from sources within possessions of the United States), or section 933 (relating to income from sources within Puerto Rico), and

(iv) Nonresident alien persons,

shall be made at such place as the Secretary or his delegate may by regulations designate.

* * * * *

(4) *Hand-carried returns.* Notwithstanding paragraph (1) * * * a return to which paragraph (1)(A) * * * would apply, but, for this paragraph, which is made to the Secretary or his delegate by hand carrying shall, under regulations prescribed by the Secretary or his delegate, be made in the internal revenue district referred to in paragraph (1)(A)(i) * * *.

(5) *Exceptional cases.* Notwithstanding paragraph (1) * * * or (4) of this subsection, the Secretary or his delegate may permit a return to be filed in any internal revenue district, and may require the return of any officer or employee of the Treasury Department to be filed in any internal revenue district selected by the Secretary or his delegate.

[Sec. 6091 as amended by sec. 1(a), Act of Nov. 2, 1966 (Public Law 89–713, 80 Stat. 1107)]

PAR. 23. Section 25.6091–1 is amended to read as follows:

§ 25.6091–1 Place for filing returns and other documents.

(a) *Returns filed with district director or Director of International Operations.* If the donor is a resident of the United States, the gift tax return required by section 6019 shall be filed with the district director for the district in which the legal residence or principal place of business of the donor is located. If the donor is a nonresident (whether or not a citizen), and his principal place of business is located in an internal revenue district, the gift tax return shall be filed with the district director for the internal revenue district in which the donor's principal place of business is located. If the donor is a nonresident (whether or not a citizen), and he does not have a principal place of business which is located in an internal revenue district, the gift tax return shall be filed with the Director of International Operations, Internal Revenue Service, Washington, D.C. 20225, or with such other official as may be designated by instructions applicable to the return.

(b) *Returns filed with service centers.* Notwithstanding paragraph (a) of this section, unless a return is filed by hand-carrying, whenever instructions applicable to gift tax returns provide that the returns be filed with a service center, the returns must be so filed in accordance with the instructions. Returns which are filed by hand-carrying shall be filed with the district director in accordance with paragraph (a) of this section.

PAR. 24. Section 25.6151 is amended by revising section 6151(a) and adding a historical note to read as follows:

§ 25.6151 Statutory provisions; time and place for paying tax shown on return.

SEC. 6151. *Time and place for paying tax shown on returns*—(a) *General rule.* Except as otherwise provided in this section, when a return of tax is required under this title or regulations, the person required to make such return shall, without assessment or notice and demand from the Secretary or his delegate, pay such tax to the principal internal revenue officer for the internal

revenue district in which the return is required to be filed, and shall pay such tax at the time and place fixed for filing the return (determined without regard to any extension of time for filing the return).

* * * * *

[Sec. 6151 as amended by sec. 4(b), Act of Nov. 2, 1966 (Public Law 89, 713, 8 Stat. 1108)]

PAR. 25. Paragraph (c) of § 25.6161–1 is amended to read as follows:

§ 25.6161–1 Extension of time for paying tax or deficiency.

* * * * *

(c) *Application for extension.* An application for an extension of the time for payment of the tax shown on the return, or for the payment of any amount determined as a deficiency, shall be in writing and shall be accompanied by evidence showing the undue hardship that would result to the donor if the extension were refused. The application shall also be accompanied by a statement of the assets and liabilities of the donor and an itemized statement showing all receipts and disbursements for each of the 3 months immediately preceding the due date of the amount to which the application relates. The application, with supporting documents, must be filed with the applicable district director referred to in paragraph (a) of § 25.6091–1 regardless of whether the return is to be filed with, or the tax is to be paid to, such district director on or before the date prescribed for payment of the amount with respect to which the extension is desired. The application will be examined by the district director, and within 30 days, if possible, will be denied, granted, or tentatively granted subject to certain conditions of which the donor will be notified. If an aditional extension is desired, the request therefor must be made to the district director on or before the expiration of the period for which the prior extension is granted.

* * * * *

Subchapter C—Employment Taxes

Part 31—Employment Taxes; Applicable on and After January 1, 1955

PAR. 26. Paragraph (b)(3) of § 31.3121(k)–1 is amended to read as follows:

§ 31.3121(k)–1 Waiver of exemption from taxes.

* * * * *

(b) *Execution and amendment of certificate.* * * *

(3) *Where to file certificate or amendment.* The certificate on Form SS–15 and accompanying list on Form SS–15a of an organization which is required to make a return on Form 941 pursuant to § 31.6011(a)–1 or § 31.6011(a)–4 shall be filed with the internal revenue officer designated in the instructions applicable to Form SS–15 and Form SS–15a. The Form SS–15 and Form SS–15a of any other organization shall be filed in accordance with the provisions of § 31.6091–1 which are otherwise applicable to returns. Each Form SS–15a Supplement shall be filed with the internal revenue officer with whom the related Forms SS–15 and SS–15a were filed.

* * * * *

PAR. 27. Paragraph (a) of § 31.3504–1 is amended to read as follows:

§ 31.3504–1 Acts to be performed by agents.

(a) *In general.* In the event wages as defined in chapter 21 or 24 of the Internal Revenue Code of 1954, or compensation as defined in chapter 22 of such Code, of an employee or group of employees, employed by one or more employers, is paid by a fiduciary, agent, or other person, or if such fiduciary, agent, or other person has the control, receipt, custody, or disposal of such wages or compensation, the district director, or director of a service center, may, subject to such terms and conditions as he deems proper, authorize such fiduciary, agent, or other person to perform such acts as are required of such employer or employers under those provisions of the Internal Revenue Code of 1954 and the regulations thereunder which have application, for purposes of the taxes imposed by such chapter or chapters, in respect of such wages or compensation. If the fiduciary, agent, or other person is authorized by the district director, or director of a service center, to perform such acts, all provisions of law (including penalties) and of the regulations prescribed in pursuance of law applicable to employers in respect of such acts shall be applicable to such fiduciary, agent, or other person. However, each employer for whom such fiduciary, agent, or other person performs such acts shall remain subject to all provisions of law (including penalties) and of the regulations prescribed in pursuance of law applicable to an employer in respect of such acts. Any application for authorization to perform such acts, signed by such fiduciary, agent, or other persons, shall be filed with the district director, or director of a service center, with whom the fiduciary, agent, or other person will, upon approval of such application, file returns in accordance with such authorization.

* * * * *

PAR. 28. Subdivision (iii) of paragraph (a)(1) of § 31.6011(b)–1 is amended to read as follows:

§ 31.6011(b)–1 Employers' identification numbers.

(a) *Requirement of application—*(1) *In general.* * * *

(iii) *Method of application.* The application, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. Form SS–4 may be obtained from any district director or director of a service center

or any district office of the Social Security Administration. The application shall be filed with the internal revenue officer designated in the instructions applicable to Form SS–4, or with the nearest district office of the Social Security Administration. The application shall be signed by (*a*) the individual, if the employer is an individual; (*b*) the president, vice president, or other principal officer, if the employer is a corporation; (*c*) a responsible and duly authorized member or officer having knowledge of its affairs, if the employer is a partnership or other unincorporated organization; or (*d*) the fiduciary, if the employer is a trust or estate. An identification number will be assigned to the employer in due course upon the basis of the information reported on the application required under this section.

* * * * *

Part 36—Contract Coverage

PAR. 29. Paragraph (a) of § 36.3121 (1)–0 is amended to read as follows:

§ 36.3121(1)–0 Introduction.

(a) The regulations in this part deal with the circumstances under which a domestic corporation may enter into an agreement with the Internal Revenue Service for the purpose of extending the insurance system established by title II of the Social Security Act to certain services performed outside the United States by citizens of the United States as employees of a foreign subsidiary of the domestic corporation, and with the obligations of a domestic corporation which enters into such an agreement. The provisions of the Internal Revenue Code of 1954, as amended, to which the regulations in this part pertain are contained in section 3121(1). The liabilities assumed under an agreement entered into pursuant to such section are based on the remuneration for services covered by the agreement. Such agreement may not be effective prior to January 1, 1955.

* * * * *

PAR. 30. Paragraphs (a)(1), (b)(3), and (c) of § 36.3121(1) (1)–1 are amended to read as follows:

§ 36.3121(1)(1)–1 Agreements entered into by domestic corporations with respect to foreign subsidiaries.

(a) *In general* (1) Any domestic corporation having one or more foreign subsidiaries may request the Internal Revenue Service to enter into an agreement for the purpose of extending the Federal old-age, survivors, and disability insurance system established by title II of the Social Security Act to certain services performed outside the United States by all citizens of the United States who are employees of any such foreign subsidiary. See § 36.-3121(1)(8)–1, relating to the definition of foreign subsidiary. Except as provided in § 36.3121(1)(5)–1, relating to the effect of the termination of an agreement entered into pursuant to the provisions of section 3121(1), the Internal Revenue Service shall, at the request of a domestic corporation enter into such agreement on Form 2032 in any case where a Form 2032 is executed, and submitted by the domestic corporation in the manner prescribed in this section. A domestic corporation may not have in effect at the same moment of time more than one agreement on Form 2032.

* * * * *

(b) *Form and contents of agreement.* * * *

(3) That the agreement shall become effective on the first day of the calendar quarter in which the Form 2032 is signed by the district director or director of the service center or on the first day of the next succeeding calendar quarter, whichever is specified in the agreement;

* * * * *

(c) *Execution and filing of Form 2032.* The request of any domestic corporation that the Internal Revenue Service enter into an agreement with the corporation on Form 2032 shall be signified by the corporation by executing and filing Form 2032 in triplicate. Such form shall be executed and filed in accordance with the regulations in this part and the instructions relating to the form. Each copy of the form shall be signed and dated by the officer of the corporation authorized to enter into the agreement, shall show the title of such officer, and shall have the corporate seal affixed thereto. A certified copy of the minutes of the meeting of the board of directors of the domestic corporation, or other evidence, showing the authority of such officer so to act shall accompany the form. Form 2032 executed and filed as provided in this paragraph shall be signed and dated by the district director or director of the service center and, upon such signing, the Form 2032 so executed and filed will constitute the agreement authorized in section 3121(1)(1). The Internal Revenue Service will return one copy of the agreement to the domestic corporation, will transmit one copy to the Department of Health, Education, and Welfare, and will retain one copy (together with all related papers).

PAR. 31. Paragraphs (c) and (d) of § 36.3121(1)(1)–2 are amended to read as follows:

§ 36.3121(1)(1)–2 Amendment of agreement.

* * * * *

(c) A domestic corporation shall signify its desire to amend an agreement entered into by the corporation as provided in § 36.3121(1)(1)–1 by executing and filing Form 2032 Supplement in triplicate.

(d) Form 2032 Supplement shall be executed and filed in the manner and in conformity with the requirements prescribed in the instructions relating to such form and in § 36.3121 (1)(1)–1(c) in respect of an agreement on Form 2032. Form 2032 Supplement executed and filed as provided in this paragraph shall be signed and dated by the district director or director of the service center, and, upon such signing, the Form 2032 Supplement so executed and filed will constitute an amendment of the agreement entered into on Form 2032. The Inter-

nal Revenue Service will return one copy of the amendment to the domestic corporation, will transmit one copy to the Department of Health, Education, and Welfare, and will retain one copy (together with all related papers).

PAR. 32. Section 36.3121(l)(2)–1 is amended to read as follows:

§ 36.3121(l)(2)–1 Effective period of agreement.

(a) *In general.* An agreement entered into as provided in § 36.3121(l)(1)–1 shall be in effect for the period beginning with the first day of the calendar quarter in which the agreement is signed by the district director or director of the service center, or the first day of the calendar quarter following the calendar quarter in which the agreement is signed by the district director or director of the service center, whichever is specified in the agreement. In no case, however, shall the agreement be effective for any calendar quarter which begins prior to January 1, 1955.

(b) *Amendment of agreement.* If an amendment on Form 2032 Supplement (filed by a domestic corporation to include in its agreement services performed for a foreign subsidiary not previously named therein) is signed by the district director or director of the service center, within the quarter for which the agreement is first effective or within the first calendar month following such quarter, the agreement shall be effective with respect to the subsidiary named in the amendment as of the date such agreement first became effective. However, if the amendment is signed by the district director or director of the service center after the last day of the fourth month for which the agreement is in effect, such agreement shall be in effect with respect to the subsidiary named in the amendment for the period beginning with the first day of the calendar quarter following the calendar quarter in which the amendment is signed by the district director or director of the service center.

PAR. 33. Paragraphs (a) and (b)(2) of § 36.3121(l)(3)–1 are amended to read as follows:

§ 36.3121(l)(3)–1 Termination of agreement by domestic corporation or by reason of change in stock ownership.

(a) *Termination by domestic corporation.* (1) A domestic corporation which has entered into an agreement under section 3121(l)(1) with respect to one or more of its foreign subsidiaries may terminate such agreement in part or in its entirety by giving (for calendar quarters beginning before 1969, to the district director for the internal revenue district in which is located the principal place of business in the United States of the domestic corporation; and for calendar quarters beginning after 1968, except as provided in paragraph (b) of § 301.6091–1 (relating to hand-carried documents) to the director of the service center serving such internal revenue district) 2 years' advance notice in writing of its desire so to terminate the agreement at the end of a specified calendar quarter: *Provided,* That, at the time of the receipt of such notice by such internal revenue officer, the agreement has been in effect with respect to the subsidiary or subsidiaries covered by the notice for at least 8 years. The notice of termination shall be signed and dated and shall show (i) the title of the officer authorized to sign the notice, (ii) the name, address, and identification number of the domestic corporation, (iii) the internal revenue officer with whom the agreement was entered into, (iv) the name and address of each foreign subsidiary with respect to which the agreement is to be terminated, (v) the date on which the agreement became effective with respect to each such foreign subsidiary, and (vi) the date on which the agreement is to be terminated with respect to each such foreign subsidiary. The notice shall be submitted in duplicate and shall be accompanied by a certified copy of the minutes of the meeting of the board of directors of the domestic corporation, or other evidence, showing authorization for the notice of termination. No particular form is prescribed for the notice of termination. The Internal Revenue Service will transmit one copy of the notice of termination to the Department of Health, Education, and Welfare.

(2) A notice of termination given by a domestic corporation in respect of any one or more of its foreign subsidiaries may be revoked by the corporation with respect to any such subsidiary or subsidiaries by giving, prior to the close of the calendar quarter specified in the notice of termination, written notice of revocation. The notice of revocation shall be filed with the internal revenue officer with whom the notice of termination was filed. Such notice of revocation shall be signed and dated and shall show (i) the title of the officer authorized to sign the notice of revocation, (ii) the name, address, and identification number of the domestic corporation, (iii) the name and address of each foreign subsidiary with respect to which the notice of termination is rovoked, and (iv) the date of the notice of termination to be revoked. The notice shall be submitted in duplicate and shall be accompanied by a certified copy of the minutes of the meeting of the board of directors of the domestic corporation, or other evidence, showing authorization for the notice of revocation. No particular form is prescribed for the notice of revocation. The Internal Revenue Service will transmit one copy of the notice of revocation to the Department of Health, Education, and Welfare.

(b) *Termination by reason of change in stock ownership.* * * *

(2) A domestic corporation which has entered into an agreement as provided in § 36.3121(l)(1)–1 shall furnish (for calendar quarters beginning before 1969, to the district director for the internal revenue district in which is located its principal place of business in the United States; and for calendar quarters beginning after 1968, except as provided in paragraph (b) of § 301.6091–1 (relating to hand-carried documents) to the director of the service center serving such internal revenue

district) written notification in the event that a foreign corporation named in the agreement, including any amendment thereof, as a foreign subsidiary of the domestic corporation ceases to be its foreign subsidiary. The written notification shall be furnished in duplicate on or before the last day of the first month following the close of the calendar quarter in which the foreign corporation ceases, at any time in such quarter, to be a foreign subsidiary of the domestic corporation. Such notification shall be signed and dated by the president or other principal officer of the domestic corporation. The written notification shall show (i) the title of the officer signing the notice, (ii) the name, address, and identification number of the domestic corporation, (iii) the internal revenue officer with whom the agreement was entered into, (iv) the date on which the agreement was entered into, (v) the name and address of the foreign corporation with respect to which the notification is furnished, and (vi) the date on which the foreign corporation ceased to be a foreign subsidiary of the domestic corporation. No particular form is prescribed for the written notification. The Internal Revenue Service will transmit one copy of the written notification to the Department of Health, Education, and Welfare.

PAR. 34. Section 36.3121(l)(7)–1 is amended by revising subparagraphs (1), (2), and (3)(ii) of paragraph (a) and by revising subdivisions (i) and (iii) of paragraph (b)(2). The revised provisions read as follows:

§ 36.3121(1)(7)–1 Overpayments and underpayments.

(a) *Adjustments*—(1) *In general.* Errors in the payment of amounts for which liability equivalent to the employee and employer taxes with respect to any payment of remuneration is incurred by a domestic corporation pursuant to its agreement are adjustable by the domestic corporation in certain cases without interest. However, not all corrections made under this section constitute adjustments within the meaning of the regulations in this part. The various situations in which such corrections constitute adjustments are set forth in subparagraphs (2) and (3) of this paragraph. All corrections in respect of underpayments and all adjustments or credits in respect of overpayments made under this section must be reported on a return filed by the domestic corporation under the regulations in this part and not on a return filed with respect to the employee and employer taxes imposed by sections 3101 and 3111, respectively. Every return on which such a correction (by adjustment, credit, or otherwise) is reported pursuant to this section must have securely attached as a part thereof a statement explaining the error in respect of which the correction is made, designating the calendar quarter in which the error was ascertained, and setting forth such other information as would be required if the correction were in respect of an overpayment or underpayment of taxes under the Federal Insurance Contributions Act. An error is ascertained when the domestic corporation has sufficient knowledge of the error to be able to correct it. An underpayment may not be corrected under this section after receipt from the district director or director of the service center of written notification of the amount due and demand for payment thereof, but the amount shall be paid in accordance with such notification.

(2) *Underpayments.* If a domestic corporation fails to report, on a return filed under the regulations in this part, all or any part of the amount for which liability equivalent to the employee and employer taxes is incurred under its agreement with respect to any payment of remuneration, the domestic corporation shall adjust the underpayment by reporting the additional amount due as an adjustment on a return or supplemental return filed on or before the last day on which the return for the return period in which the error is ascertained is required to be filed. The amount of each underpayment adjusted in accordance with this subparagraph shall be paid, without interest, at the time fixed for reporting the adjustment. If an adjustment is reported pursuant to this subparagraph but the amount thereof is not paid when due, interest thereafter accrues.

(3) *Overpayments.* * * *

(ii) A correction may not be made in one calendar year in respect of any part of an overpayment which was collected from an individual in a prior calendar year unless the domestic corporation has secured the written statement of the individual showing that he has not claimed and will not claim refund or credit of the amount so collected, and retains such receipt as a part of its records. See § 31.6413(c)–1 of this chapter, relating to claims for special credit or refund.

The correction constitutes an adjustment under this subparagraph only if it is reported on the return for the period in which the error is ascertained or on the return for the next following period, and then only if the correction is reported within the statutory period of limitation upon refund or credit of overpayments of amounts due under the agreement. See paragraph (b)(2)(iii) of this section relating to such statutory period. A claim for credit or refund may be filed in accordance with the provisions of paragraph (b)(2) of this section for any overpayment of an amount due under the agreement which is not adjusted under this subparagraph.

(b) *Errors not adjustable.* * * *

(2) *Overpayments.* (i) If more than the correct amount due from a domestic corporation pursuant to its agreement (including the amount of any interest or addition) is paid and the amount of the overpayment is not adjusted under paragraph (a)(3) of this section, the domestic corporation may file a claim for refund or credit. Except as otherwise provided in this subparagraph, such claim shall be made in the same manner and subject to the same conditions as to allowance of the claim

as would be the case if the claim were in respect of an overpayment of taxes under the Federal Insurance Contributions Act. Refund or credit of an amount erroneously paid by a domestic corporation under its agreement may be allowed only to the domestic corporation.

* * * * *

(iii) No refund or credit of an overpayment of the amount due from a domestic corporation under its agreement will be allowed after the expiration of 2 years after the date of payment of such overpayment, except upon one or more of the grounds set forth in a claim filed prior to the expiration of such 2-year period.

* * * * *

Subchapter D—Miscellaneous Excise Taxes

Part 41—Excise Tax on Use of Certain Highway Motor Vehicles

PAR. 35. Paragraph (a) (1) of § 41.6109–1 is amended to read as follows:

§ 41.6109–1 Employer identification numbers.

(a) *Requirement of application*—(1) *In general.* An application on Form SS–4 for an employer identification number shall be made by every person in whose name a highway motor vehicle is registered at a time, after September 30, 1962, when a taxable use of such vehicle occurs, but who prior to such time neither has been assigned an employer identification number nor has applied therefor. The application, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for Form SS–4 may be obtained from any district director or director of a service center. The application shall be filed with the internal revenue officer designated in the instructions applicable to Form SS–4. The application shall be signed by (i) the individual, if the person is an individual; (ii) the president, vice president, or other principal officer, if the person is a corporation; (iii) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (iv) the fiduciary, if the person is a trust or estate. An employer identification number will be assigned to the person in due course upon the basis of information reported on the application required under this section.

* * * * *

Part 45—Miscellaneous Stamp Taxes

PAR. 36. Paragraph (a) (1) of § 45.6109–1 is amended to read as follows:

§ 45.6109–1 Employer identification numbers.

(a) *Requirement of application*—(1) *In general.* An application on Form SS–4 for an employer identification number shall be made by every person who, at any time after September 30, 1962, performs any act with respect to which a tax is imposed by section 4461, 4471, 4821, or 4841, but who prior to such time neither has been assigned an employer identification number nor has applied therefor. The application, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. Form SS–4 may be obtained from any district director or director of a service center. The application shall be filed with the internal revenue officer designated in the instructions applicable to Form SS–4. The application shall be signed by (i) the individual, if the person is an individual; (ii) the president, vice president, or other principal officer if the person is a corporation; (iii) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (iv) the fiduciary, if the person is a trust or estate. An employer identification number will be assigned to the person in due course upon the basis of information reported on the application required under this section.

* * * * *

Part 46—Regulations Relating to Miscellaneous Excise Taxes Payable by Return

PAR. 37. Paragraph (a) (1) of § 46.6109–1 is amended to read as follows:

§ 46.6109–1 Employer identification numbers.

(a) *Requirement of application*—(1) *In general.* An application on Form SS–4 for an employer identification number shall be made by every person who, at any time after September 30, 1962, performs any manufacturing or processing operation with respect to which a tax is imposed by section 4501 (a) or 4511, but who prior to such time neither has been assigned an employer identification number nor has applied therefor. The application, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. Form SS–4 may be obtained from any district director or director of a service center. The application shall be filed with the internal revenue officer designated in the instructions applicable to Form SS–4. The application shall be signed by (i) the individual, if the person is an individual; (ii) the president, vice president, or other principal officer, if the person is a corporation; (iii) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (iv) the fiduciary, if the person is a trust or estate. An employer identification number will be assigned to the person in due course upon the basis of information reported on the application required under this section.

* * * * *

Part 48—Manufacturers and Retailers Excise Taxes

PAR. 38. Paragraph (a)(1) of § 48.6109–1 is amended to read as follows:

§ 48.6109–1 Employer identification numbers.

(a) *Requirement of application*—(1) *In general.* An application on Form SS–4 for an employer identification number shall be made by every person who, at any time after September 30, 1962, makes a sale of an article with respect to which a tax is imposed by chapter 31 or 32 of the Code, but who prior to such time neither has been assigned an employer identification number nor has applied therefor. The application, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. Form SS–4 may be obtained from any district director or director of a service center. The application shall be filed with the internal revenue officer designated in the instructions applicable to Form SS–4. The application shall be signed by (i) the individual, if the person is an individual; (ii) the president, vice president, or other principal officer, if the person is a corporation; (iii) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (iv) the fiduciary, if the person is a trust or estate. An employer identification number will be assigned to the person in due course upon the basis of information reported on the application required under this section.

* * * * *

Part 49—Facilities and Services Excise Taxes

PAR. 39. Paragraph (a)(1) of § 49.6109–1 is amended to read as follows:

§ 49.6109–1 Employer identification numbers.

(a) *Requirement of application*—(1) *In general.* An application on Form SS–4 for an employer identification number shall be made by every person who, at any time after September 30, 1962, receives a payment for a facility or service with respect to which a tax is imposed by chapter 33 of the Code, but who prior to such time neither has been assigned an employer identification number nor has applied therefor. The application, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. Form SS–4 may be obtained from any district director or director of a service center. The application shall be filed with the internal revenue officer designated in the instructions applicable to Form SS–4. The application shall be signed by (i) the individual, if the person is an individual; (ii) the president, vice president, or other principal officer, if the person is a corporation; (iii) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (iv) the fiduciary, if the person is a trust or estate. An employer identification number will be assigned to the person in due course upon the basis of information reported on the application required under this section.

* * * * *

Part 147—Temporary Regulations Under the Interest Equalization Tax Act

PAR. 40. That part of paragraph (b) of § 147.1–1 which precedes subparagraph (1) is amended to read as follows:

§ 147.1–1 Credit or refund in case of insurance companies.

* * * * *

(b) *Credit or refund for overpayment of tax.* If an insurance company is entitled to a credit or refund (without interest) for overpayment of tax in 1964 or in any subsequent calendar year under paragraph (a) of this section, the company may, in accordance with the applicable provisions of § 301.6402–2 of this chapter (Regulations on Procedure and Administration), file a claim for refund on Form 843 or claim credit for such overpayment on any return made on Form 3780 after the close of such calendar year. Each claim for credit or refund must be accompanied by a statement which shall include the following information.

* * * * *

PAR. 41. Paragraph (c)(1) of § 147.2–1 is amended to read as follows:

§ 147.2–1 Credit or refund in case of direct investments.

* * * * *

(c) *Refund or credit for overpayment*—(1) *Filing of claim.* A claim for refund or credit (without interest) for an overpayment of tax under paragraph (b) of this section shall be made in accordance with the applicable provisions of § 301.6402–2 of this chapter (Regulations on Procedure and Administration). The taxpayer may file a claim for refund on Form 843 or claim credit for the amount on a return on Form 3780. Each claim of credit or refund must be accompanied by a statement setting forth the applicable information required by subparagraph (2) of this paragraph.

* * * * *

PAR. 42. Paragraph (c)(4) of § 147.4–1 is amended to read as follows:

§ 147.4–1 Exclusion for original or new issues where required for international monetary stability.

* * * * *

(c) *Notice of acquisition of Canadian issues.* * * *

(4) *Extensions of time.* Extensions of time within which a notice of acquisition must be filed will be granted for good cause. Except as provided in

paragraph (b) of § 301.6091–1 (relating to hand-carried documents) the request for extension of time shall be made to the internal revenue officer (including the Director of International Operations, Washington, D.C. 20225) with whom the acquiring U.S. person files his income tax return.

* * * * *

PAR. 43. Paragraph (b)(1) of § 147.6–1 is amended to read as follows:

§ 147.6–1 Credit or refund in case of sales by underwriters and dealers to foreign persons.

* * * * *

(b) *Refund or credit for overpayment*—(1) *In general.* A claim for refund or credit for an overpayment of tax under paragraph (a) of this section shall be made in accordance with the applicable provisions of § 301.6402–2 of this chapter (Regulations on Procedure and Administration). The taxpayer may file a claim for refund on Form 843 or claim credit for the amount on a return on Form 3780. Each claim for credit or refund must be accompanied by a statement setting forth the applicable information required by paragraph (d) of this section.

* * * * *

PAR. 44. Paragraph (d) of § 147.8–1 is amended to read as follows:

§ 147.8–1 Interest equalization quarterly tax return.

* * * * *

(d) *Place for filing returns.* The return under paragraph (a) of this section shall be filed with the internal revenue officer designated in instructions applicable to such return.

PAR. 45. Paragraph (b) of § 147.8–3 is amended to read as follows:

§ 147.8–3 Reporting requirements for members of exchanges and associations.

* * * * *

(b) *Time and manner of filing information return.* The information referred to in paragraph (a) of this section shall be furnished on return Form 3845, Brokers' Quarterly Information Return. Each such return shall contain all of the information required by such form and the accompanying instructions. Form 3845 shall be filed with the internal revenue officer designated in instructions applicable to Form 3845. Form 3845 shall be filed on or before the last day of the month following the close of each calendar quarter beginning on or after July 1, 1964.

Part 151—Regulatory Taxes on Narcotic Drugs

PAR. 46. Paragraph (c) of § 151.30 is amended to read as follows:

§ 151.30 Employer identification numbers.

* * * * *

(c) The application on Form SS–4, together with any supplementary statement shall be prepared in accordance with the form, instructions and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. Form SS–4 may be obtained from any district director or director of a service center. The application on Form SS–4 shall be filed with the internal revenue officer designated in the instructions applicable to Form SS–4. The application shall be filed on or before the seventh day after the first date, after September 30, 1962, on which occurs any act with respect to which a tax is imposed by section 4721. The application shall be signed by (1) the individual, if the person is an individual; (2) the president, vice president, or other principal officer if the person is a corporation; (3) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (4) the fiduciary, if the person is a trust or estate. An employer identification number will be assigned to the person in due course upon the basis of the information reported on the application required under this section.

* * * * *

Part 152—Regulatory Taxes on Marihuana

PAR. 47. Paragraph (c) of § 152.28 is amended to read as follows:

§ 152.28 Employer identification numbers.

* * * * *

(c) The application on Form SS–4, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. Form SS–4 may be obtained from any district director or director of service center. The application on Form SS–4 shall be filed with the internal revenue officer designated in the instructions applicable to Form SS–4. The application shall be filed on or before the seventh day after the first date, after September 30, 1962, on which occurs any act with respect to which a tax is imposed by section 4751. The application shall be signed by (1) the individual, if the person is an individual; (2) the president, vice president, or other principal officer if the person is a corporation; (3) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (4) the fiduciary, if the person is a trust or estate. An employer identification number will be assigned to the person in due course upon the basis of the information reported on the application required under this section.

* * * * *

Subchapter F—Procedure and Administration

Part 301—Procedure and Administration

PAR. 48. Section 301.6091–1 is amended by adding at the end thereof the following new paragraph:

§ 301.6091–1 Place for filing returns and other documents.

* * * * *

(c) *Definition of hand carried.* For purposes of this section and section

6091(b)(4) and the regulations issued thereunder, a return or document will be considered to be hand carried if it is brought to the district director by the person required to file the return or other document, or by his agent. Examples of persons who will be considered to be agents, for purposes of the preceding sentence, are: Members of the taxpayer's family, an employee of the taxpayer, the taxpayer's attorney, accountant, or tax advisor, and messengers employed by the taxpayer. A return or document will not be considered to be hand carried if it is sent to the Internal Revenue Service through the U.S. Mail.

(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).)

RANDOLPH W. THROWER,
Commissioner of Internal Revenue.

Approved May 12, 1969.

EDWIN S. COHEN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 14, 1969, 8:50 a.m., and published in the issue of the Federal Register for May 15, 1969, 34 F. R. 7687)

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26 CFR 301.6091–1: Place for filing returns and other documents.

Definition of hand carried for purposes of the direct filing of miscellaneous returns and documents. See T.D. 7012, page 244.

Subchapter B. Miscellaneous Provisions

Section 6103.—Publicity of Returns and Disclosure of Information as to Persons Filing Income Tax Returns

26 CFR 301.6103–101: Inspection of returns by committees of Congress other than those enumerated in section 6103(d).

E. O. 11483

INSPECTION OF INCOME TAX RETURNS BY THE SELECT COMMITTEE ON CRIME, HOUSE OF REPRESENTATIVES

By virtue of the authority vested in me by section 6103(a) of the Internal Revenue Code of 1954, as amended (26 U.S.C. 6103(a)), it is hereby ordered that any income tax return for the years 1960 to 1970, inclusive, shall, during the Ninety-first Congress, be open to inspection by the Select Committee on Crime, House of Representatives, or any duly authorized subcommittee thereof, in connection with its study and investigation of all aspects of crime in the United States, pursuant to House Resolution 17, 91st Congress, agreed to May 1, 1969. Such inspection shall be in accordance and upon compliance with the rules and regulations prescribed by the Secretary of the Treasury in Treasury Decision 6132 [C.B. 1955–1, 142], relating to the inspection of returns by committees of the Congress, approved by the President on May 3, 1955.

RICHARD NIXON.

THE WHITE HOUSE,
September 23, 1969.

(Filed by the Office of the Federal Register on September 23, 1969; 4:56 p.m., and published in the issue of the Federal Register for September 25, 1969, 34 F.R. 14757)

Section 6109.—Identifying Numbers

26 CFR 1.6109–1: Identifying numbers.

Filing applications for employer identification numbers with service centers. See T.D. 7012, page 244.

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26 CFR 41.6109–1: Employer identification numbers.

Amended regulations in Parts 45, 46, 48, 49 for miscellaneous excise taxes, and Parts 151 and 152 for the regulatory taxes on narcotic drugs and marihuana, respectively, relating to the filing of applications for employer identification numbers with service centers. See T.D. 7012, page 244.

Chapter 62—Time and Place for Paying Tax

Subchapter A. Place and Due Date for Payment of Tax

Section 6151.—Time and Place for Paying Tax Shown on Returns

26 CFR 20.6151–1: Time and place for paying tax shown on the return.

Procedure for using certain Treasury bonds in payment of Federal estate tax. See Rev. Proc. 69–18, page 300.

Section 6155.—Payment on Notice and Demand

26 CFR 301.6155–1: Payment on notice and demand.

Procedure for using certain Treasury bonds in payment of Federal estate tax. See Rev. Proc. 69–18, page 300.

Chapter 65—Abatements, Credits and Refunds

Subchapter A. Procedure in General

Section 6402.—Authority To Make Credits or Refunds

26 CFR 301.6402–2: Claims for credit or refund.

Whether credit or refund of the manufacturers excise taxes imposed under chapter 32 of the Code is available to a receiver or trustee in bankruptcy. See Rev. Rul. 69–531, page 260.

Subchapter B. Rules of Special Application

Section 6411.—Tentative Carryback Adjustments

26 CFR 1.6411–1: Tentative carryback adjustments.
(Also Section 825; 1.825–1.)

Mutual casualty insurance companies may properly submit Form 1139, Application for Tentative Carryback Adjustment, under the provisions of section 6411(a) of the Code with respect to the unused loss deduction carryback allowed by section 825(e).

Rev. Rul. 69–660

Advice has been requested whether Form 1139, Application for Tentative Carryback Adjustment, may properly be submitted by a mutual casualty insurance company taxable under section 821 of the Internal Revenue Code of 1954.

Section 6411(a) of the Code, provides, in part, as follows:

(a) Application for Adjustment.—A taxpayer may file an application for a tentative carryback adjustment of the tax for the prior taxable year affected by a net operating loss carryback provided in section 172(b), or by an investment credit carryback provided in section 46(b), from any taxable year. * * *

Section 822 (c)(8)(B) of the Code, applicable to the determination of tax-

able investment income of mutual casualty insurance companies, and section 823(b)(1) of the Code applicable to the determination of statutory underwriting income or loss of mutual casualty insurance companies, specifically prohibit the allowance of a net operating loss deduction under section 172 of the Code to such companies. These provisions were necessary to eliminate the possibility of a double deduction, since section 825 of the Code provides for an unused loss deduction tailored to the specific requirements of mutual casualty insurance companies. In order to make the grant of the section 825 deduction complete to mutual casualty insurance companies, it was necessary to extend to such companies the relief provisions of section 6411 of the Code. Thus, section 1.825–1(e) of the Income Tax Regulations provides, in part:

(e) Ascertainment of deduction dependent upon unused loss carryback. * * * When the company ascertains the unused loss carryback, it may within the applicable period of limitations file a claim for credit or refund of the overpayment, if any, resulting from the failure to compute the unused loss deduction for the taxable year with the inclusion of such carryback; or it may file an application under the provisions of section 6411 for a tentative carryback adjustment.

Accordingly, it is held that the provisions of section 6411(a) of the Code are applicable to the unused loss deduction carryback allowed by section 825(e) of the Code and that the application for Tentative Carryback Adjustment, Form 1139, may be properly submitted by the mutual casualty insurance company.

Section 6415.—Credits or Refunds to Persons Who Collected Certain Taxes

26 CFR 301.6415–1: Credits or refunds to persons who collected certain taxes.

Whether the absence of consents to the allowance of a refund of an overpayment of facilities and services excise taxes makes a timely filed claim defective, so far as timely filing is concerned. See Rev. Rul. 69–508, page 262.

Section 6416.—Certain Taxes on Sales and Services

26 CFR 48.6416(b)–1: Readjustments of price on which manufacturers or retailers excise tax is based.

A demonstrator's expenses and commissions paid by a manufacturer in connection with sales of taxable articles constitute part of the manufacturer's selling price and are not a "price readjustment" that gives rise to a credit or refund; S.T. 678 superseded.

Rev. Rul. 69–530 [1]

A manufacturer sells articles that are subject to an ad valorem manufacturers excise tax imposed under Chapter 32 of the Internal Revenue Code of 1954. In connection with sales to dealers, the manufacturer furnishes the dealers free of charge, someone to demonstrate the articles, and pays all of the demonstrator's expenses plus a commission equal to a certain percentage on all resales of articles made by the dealer during the demonstrator's stay.

Held, the demonstrator's expenses and commissions paid by the manufacturer constitute a part of the manufacturer's selling expense and are not a "price readjustment" within the meaning of section 6416(b)(1) of the Code. Accordingly, the payment of such expenses does not give rise to a right to credit or refund of manufacturers excise tax. See section 48.6416(b)–1(b) of the Manufacturers and Retailers Excise Tax Regulations, which provides that commissions to agents, or allowances, payments, or adjustments made to persons other than the manufacturer's vendee are not considered as effectuating price readjustments under any circumstances.

S.T. 678, C.B. XII–I, 415 (1933), is hereby superseded since the position set forth therein is restated under current law in this Revenue Ruling.

26 CFR 48.6416(b)–2: Tax payments deemed to be overpayments by reason of certain uses, sales, or resales.

Whether credit or refund of the manufacturers excise tax is allowable where gasoline is purchased by employees of a nonprofit educational organization for use in their private automobiles when traveling on official business for the organization. See Rev. Rul. 69–396, page 214.

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26 CFR 48.6416(b)–2: Tax payments deemed to be overpayments by reason of certain uses, sales, or resales.

Whether a credit or refund of manufacturers excise tax paid on automotive parts is available in a particular case involving further manufacture. See Rev. Rul. 69–437, page 208.

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26 CFR 48.6416(b)–3: Articles sold tax-paid by manufacturers thereof to another manufacturer for specified use.

Whether credit or refund of manufacturers excise tax is allowable in the case of tax-paid automotive parts furnished to the manufacturer of the taxable article by his customer who is not a manufacturer or producer of any article. See Rev. Rul. 69–437, page 208.

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26 CFR 48.6416(f)–1: Credit on returns. (Also Section 6402; 301.6402–2.)

A trustee in bankruptcy may not take credit on a return filed by him for an overpayment made by a bankrupt manufacturer prior to his being declared a bankrupt; the trustee may file a claim for refund; S.T. 443 superseded.

Rev. Rul. 69–531 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in S.T. 443, C.B. III–1, 467 (1924).

The question is whether a trustee in bankruptcy may take a credit on a return filed by the trustee for the overpayment of manufacturers excise tax paid by the bankrupt on a return filed prior to his being declared a bankrupt.

A manufacturer of articles subject to a manufacturers excise tax imposed under chapter 32 of the Internal Revenue Code of 1954 was adjudged a bankrupt. The bankrupt's business was placed in the hands of a trustee pending settlement of the bankruptcy pro-

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[1] Prepared pursuant to Rev. Proc. 67–6, C.B. 1967–1, 576.

ceedings. Prior to being adjudged a bankrupt the manufacturer reported and paid manufacturers excise tax on sales of his products. During this period the manufacturer, through rebates and allowances, made certain readjustments of selling price on which tax had previously been reported and paid.

Under the provisions of section 6416(b)(1) of the Code, if the price of an article in respect of which a tax, based on such price, is readjusted by reason of a bona fide rebate or allowance, a proportionate part of the tax paid on the sale of the article is deemed to be an overpayment of tax, and the manufacturer is entitled to a credit or refund of the overpaid tax.

At the time he was adjudged a bankrupt, the manufacturer in the instant case had not filed for credit or refund of the overpaid tax. Upon assuming responsibility for operation of the bankrupt's business, the trustee in bankruptcy continued to manufacture and sell taxable products, and he reported and paid the tax liability incurred thereon in his capacity as trustee.

Section 6416(f) of the Code provides that any person entitled to claim refund of manufacturers excise tax imposed under chapter 32 may, in lieu of claiming refund of such tax, claim credit for such tax on any subsequent return.

The person entitled to a refund of an overpayment of tax arising under section 6416(b)(1) of the Code is the person who filed the return and paid the tax to the Government. Since section 6416(f), in providing for a credit in lieu of a claim for refund, refers only to subsequent returns, such subsequent returns must be returns of the person who made the prior return and paid the tax shown thereon.

Accordingly, a receiver or trustee may not take credit for an overpayment of manufacturers excise tax, made by a taxpayer prior to his adjudication as a bankrupt, against tax due on a return made by a receiver or trustee for a tax liability incurred during a period the receiver or trustee operated the bankrupt's business. However, a receiver or trustee may file a claim for refund of such an overpayment of tax, in his capacity as successor in interest to the bankrupt.

Therefore, it is held in the instant case that the trustee may not take credit for the overpayment of tax made by the bankrupt.

S.T. 443 is hereby superseded, since the conclusion thereof is restated under current law in this Revenue Ruling.

Section 6421.—Gasoline Used for Certain Nonhighway Purposes or by Local Transit Systems

26 CFR 48.6421(a)–1: Payments to ultimate purchaser of gasoline used for certain nonhighway purposes.
(Also Sections 39, 6424.)

Credit allowable under section 6421(a) of the Code for tax paid on gasoline and lubricating oil by a nonresident owner of foreign registered civil aircraft must be claimed on an income tax return even though such return is not otherwise required.

Rev. Rul. 69–406

Advice has been requested as to how, under the circumstances described below, a person (individual or corporation) who is not subject to United States income tax may obtain a payment in the amount of the manufacturers excise tax paid on gasoline used for certain nonhighway purposes.

A nonresident owner of civil aircraft registered in a foreign country purchases gasoline for use in aircraft employed in trade between the United States and its possessions. The foreign country does not meet the reciprocity requirements of section 4221(e)(1) of the Internal Revenue Code of 1954. Thus, the gasoline producer must sell the gasoline to the owner on a tax-paid basis. The amount of gasoline tax for which the owner desires a payment under section 6421(a) of the Code does not amount to $1,000 with respect to gasoline used during any of the first three quarters of his taxable year and, thus, cannot be made the subject of a quarterly claim under section 6421(c)(3)(B) of the Code.

Section 6421(a) of the Code provides, in general, that if gasoline is used otherwise than as a fuel in a highway vehicle, payment (without interest) shall be made to the ultimate purchaser in the amount of 1 cent a gallon or 2 cents a gallon, depending upon the rate of tax imposed under section 4081 of the Code upon the sale of the gasoline. However, under the provisions of sections 6421(i)(3) and 39(a)(2) of the Code the payment authorized by section 6421(a) is allowed as a credit against the taxpayer's income tax, rather than as a direct payment to the taxpayer.

Section 6421(i)(1) of the Code, relating to persons not subject to income tax, provides that payments under section 6421(a) shall be made only to the United States, States, local governments, and certain tax-exempt organizations.

Section 882(c)(2) of the Code provides that a foreign corporation shall receive the benefit of credits allowed to it only by filing or causing to be filed a true and accurate return in the prescribed manner, including therein all the information that the Secretary of the Treasury or his delegate may deem necessary for the calculation of such credits. That section further provides that such provision is not to be construed to deny the credit provided by section 39 of the Code for certain uses of gasoline. Section 874(a) of the Code contains a similar provision in respect of nonresident alien individuals.

The foregoing provisions of the statute indicate that (1) direct payments under section 6421(a) are made only to specified governmental and tax-exempt organizations and (2) the amount of the gasoline tax credit should be taken on an income tax return, even though a return is not otherwise required.

Accordingly, it is held that the nonresident owner of the aircraft must file a United States income tax return and

claim the payment allowable under section 6421(a) of the Code as a credit on the return. A Form 4136, Computation of Credit for Federal Tax on Gasoline and Lubricating Oil, should be attached to the return to support the credit claimed. The conclusion in this Revenue Ruling is also applicable for claiming the payment allowable under section 6424(a) of the Code, relating to lubricating oil used other than in a highway motor vehicle, where the facts set forth above are the same.

Section 6424.—Lubricating Oil Not Used in Highway Motor Vehicles

Method by which a nonresident owner of aircraft registered in a foreign country may obtain a payment of the lubricating oil tax where such oil is used otherwise than in a highway motor vehicle. See Rev. Rul. 69–406, page 261.

Chapter 66—Limitations

Subchapter A. Limitations on Assessment and Collection

Section 6501.—Limitations on Assessment and Collection

26 CFR 301.6501(a)–1: Period of limitations upon assessment and collection.

Whether assessment and collection of deficiencies resulting from disallowance of investment credit carryovers can be made where the year in which the investment credit was claimed is barred. See Rev. Rul. 69–543, page 1.

Subchapter B. Limitations on Credit or Refund

Section 6511.—Limitations on Credit or Refund

26 CFR 301.6511(a)–1: Period of limitation on filing claim.
(Also Sections 4251, 4261, 6415; 301.6415–1.)

Whether a failure to file written consents or evidence of repayment of facilities and services taxes prior to the expiration of the period prescribed by section 6511(a) of the Code will render a claim for refund invalid as not timely filed.

Rev. Rul. 69–508

Advice has been requested whether a claim for refund of an amount overpaid as communications excise tax is timely filed under the circumstances described below.

A claim for refund of an overpayment of the tax imposed by section 4251 of the Internal Revenue Code of 1954 was filed by a communications company. The claim was filed within the limitation period prescribed by section 6511(a) of the Code for filing such claims. After the expiration of this limitation period the company repaid the amount of the tax to some of the persons from whom it had been collected, and obtained written consents to the allowance of the refund from other persons from whom the tax had been collected.

Section 6511(a) of the Code prescribes the period of limitations within which claims for credit or refund of internal revenue taxes must be filed. Under the pertinent provision of this section a claim for credit or refund must be filed within three years from the time the return was filed, or two years from the time the tax was paid, whichever period expires later.

Section 6415(a) of the Code provides that a credit or refund of an overpayment of the taxes imposed by sections 4251 and 4261 of the Code may be allowed to the person who collected the tax and paid it to the United States. However, the person collecting and paying the tax must establish that he has either (a) repaid the amount of such tax to the person from whom he collected it, or (b) has obtained that person's consent to the allowance of such credit or refund.

The question presented is whether the repayment or consent requirements prescribed by section 6415(a) of the Code are conditions precedent to proper and timely filing of a claim for credit or refund under section 6511(a) of overpayments of the tax imposed by section 4251 of the Code, or whether these requirements contemplate the furnishing of supporting evidence and may be met at any time prior to final disposition of the claim by the Internal Revenue Service.

It is held that the alternative requirements set forth in section 6415(a) of the Code are not conditions precedent to the timely filing of a claim for credit or refund of an overpayment of the tax imposed by section 4251 of the Code. Accordingly, if a claim for credit or refund of communications tax is filed by a communications company within the limitation period prescribed by section 6511(a) of the Code, the fact that neither the amount of the tax in question has been repaid to the person from whom it was collected, nor such person's consent to the allowance of a credit or refund has been obtained prior to the expiration of the period for filing claims prescribed by section 6511(a), will cause the claim to be considered invalid *as not timely filed.*

If the proof of repayment or consent required by section 6415(a) of the Code has not been submitted to the Service prior to the time the Service has completed processing of the claim, the claim will be disallowed on the grounds that the requirements for allowance prescribed by section 6415(a) of the Code have not been met. However, the claim may be reopened and reconsidered to the extent that proof of repayment or obtaining of consent is presented to the District Director, provided the additional proof of repayment or consent is submitted to the District Director in sufficient time for his office to reconsider and take action on the claim prior to the expiration of the two-year limitation period prescribed by section 6532(a)(1) of the Code within which suit may be brought on disallowed claims.

The District Director must be given sufficient time to act within the two-year period for bringing suit because section 6514(a)(2) of the Code renders any credit or refund of tax based on a timely filed but disallowed claim erroneous, if the credit or refund was made after the period of limitation for bringing suit, unless within such period suit was begun by the taxpayer. If a District Director is

unable to act on a previously disallowed claim within the two-year period for bringing suit, he will be required under the provisions of section 6514(a)(2) to disallow such a claim.

The conclusions set forth above are also applicable to claims filed by transportation companies for credit or refund of tax paid under section 4261 of the Code, and to claims for overpayments of taxes paid under sections 4231(1), 4231(2), 4241, and 4286 (all repealed) for which timely claims may be filed, as well as to timely claims filed for manufacturers excise taxes imposed under Chapter 32 of the Code.

Revenue Ruling 58–563, C.B. 1958–2, 892, which relates to claims for refund of manufacturers excise tax, reaches a conclusion similar to the one reached in this Revenue Ruling with respect to whether a failure to file written consents or evidence of repayment prior to the expiration of the period prescribed by section 6511(a) of the Code will render a claim invalid as not timely filed. However, Revenue Ruling 58–563 does not address itself to the question of the consequences of filing written consents or proof of repayment subsequent to the disallowance of a claim for failure to file such evidence. On the other hand, Revenue Ruling 59–212, C.B. 1959–1, 692, which relates to claims for refund of the employee tax under the Federal Insurance Contributions Act and the Railroad Retirement Tax Act, addresses itself to both aspects of the problem, and reaches conclusions similar to those reached in the instant Revenue Ruling.

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.

Redemption date in which Treasury bonds are redeemed in payment of Federal estate tax. See Rev. Rul. 69–489, page 172.

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.
(Also Section 6020; 301.6020–1.)

Preparation and execution of a Form 941, Employer's Quarterly Federal Tax Return, by the District Director of Internal Revenue terminates the period of delinquency for purposes of section 6651 of the Code.

Rev. Rul. 69–397

Advice has been requested whether the preparation and execution of a Form 941, Employer's Quarterly Federal Tax Return, by the District Director of Internal Revenue, under the authority of section 6020(b)(1) of the Internal Revenue Code of 1954, stops the running of the period of delinquency for purposes of section 6651 of the Code under the circumstances set forth below.

The taxpayer was liable for employment taxes (income tax withholding and F.I.C.A. taxes) for the first quarter of 1968, but did not file a return. The return was due on or before April 30, 1968. Under authority of section 6020(b)(1) of the Code, the District Director prepared and executed a Form 941 for that quarter on July 24, 1968. The taxpayer did not establish reasonable cause for failure to file the return and did not sign the return.

Section 6651(a) of the Code provides that in case of failure to file any required return, where such failure is not due to reasonable cause, the taxpayer will be liable for an additional five percent of the tax required to be shown on such return if the failure is for not more than one month, with an additional five percent for each additional month or fraction thereof, not to exceed 25 percent in the aggregate.

Section 6020(b)(1) of the Code authorizes the Secretary of the Treasury or his delegate to make any return from his own knowledge in circumstances where the taxpayer has failed to make a return, or where the taxpayer has made a false or fraudulent return. Section 6020(b)(2) provides that any return so made and subscribed by the Secretary or his delegate *shall be prima facie good and sufficient for all legal purposes.*

The emphasized phrase in the preceding sentence has been interpreted to mean that a return filed by the Secretary or his delegate becomes the return of the person for whom it is filed and stands on the same basis as a return filed by that person. *Joe Goldberg* v. *Commissioner,* 14 B.T.A. 465 (1928), and *Sarah Briarly* v. *Commissioner,* 29 B.T.A. 256 (1933).

It is held that the preparation and execution of the Form 941 by the District Director under the provisions of section 6020(b)(1) of the Code in this case stopped the running of the period of delinquency for purposes of section 6651(a). Therefore, the taxpayer is liable for an additional 15 percent of the tax.

Subchapter B. Assessable Penalties

Section 6672.—Failure to Collect and Pay Over Tax, or Attempt to Evade or Defeat Tax

26 CFR 301.6672–1: Failure to collect and pay over tax, or attempt to evade or defeat tax.

Elimination of administrative appeals procedure in certain cases arising in District Collection Division. See Rev. Proc. 69–26, page 308.

Chapter 72—Licensing and Registration

Subchapter A. Licensing

Section 7001.—Collection of Foreign Items

26 CFR 301.7001–1: License to collect foreign items.

Whether a domestic corporation acting as a nominee for the customers of a domestic bank must obtain a license to collect foreign items where the bank has obtained

a license and is making the required information returns on such items. See Rev. Rul. 69–439, page 243.

Chapter 80.—General Rules

Subchapter A. Application of Internal Revenue Laws

Section 7805.—Rules and Regulations

26 CFR 301.7805–1: Rules and regulations.

Additional obsolete rulings relating primarily to the administrative provisions of the Internal Revenue Code are listed.

Rev. Rul. 69–420

Revenue Procedure 67–6, C.B. 1967–1, 576, anounced a program for the review of rulings published in the Internal Revenue Bulletin before 1953 for the primary purpose of identifying and declaring obsolete those rulings which, although not specifically revoked or superseded, are not considered determinative with respect to future transactions.

In accordance with that program and based on a review of certain rulings relating primarily to the administrative provisions of the Internal Revenue Code, the rulings listed below are hereby declared obsolete.

Solicitor's Memorandum (S.M. or S.) Ruling Series

S.M. (or S.)

3451, C.B. IV–2, 83

Treasury Decision (T.D.) Ruling Series

T.D.

2882, C.B. 1, 258
2903, C.B. 1, 265
3260, C.B. 5, 243
3482, C.B. II–1, 343
4262, C.B. VIII–1, 115
4265, C.B. VIII–1, 110
4266, C.B. VIII–1, 111

Mimeograph (Mim.) Ruling Series

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2195, C.B. 1, 253
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3281, C.B. IV–1, 56
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3428, C.B. V–1, 119
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4431, C.B. XV–1, 501
4496, C.B. XV–2, 530
4814, C.B. 1938–2, 96
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The purpose of this declaration of obsoleteness is to make clear to all concerned that the above-listed rulings are not determinative with respect to future transactions. It is not the purpose of this Revenue Ruling to determine the applicability of any of the listed rulings to past transactions.

Other rulings relating to administrative provisions published before 1953 are currently being reviewed. Therefore, failure to include any particular ruling in this or previous lists should not be construed as indicating that the ruling necessarily has continuing application to future transactions.

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26 CFR 301.7805–1: Rules and regulations.

Additional rulings relating to income and profits taxes and employment taxes that have been declared obsolete are listed.

Rev. Rul. 69–661

Revenue Procedure 67–6, C.B. 1967–1, 576, announced a program for the review of rulings published in the Internal Revenue Bulletin before 1953 with the immediate objective of identifying and publishing lists of those rulings which, although not specifically

revoked or superseded, are not considered to be determinative with respect to future transactions.

In accordance with that program and based on a review of ruling relating primarily to income and profits taxes and to employment taxes, the rulings listed below are hereby declared obsolete.

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The purpose of this declaration of obsoleteness is to make it clear to all concerned that the above-listed rulings are not determinative with respect to future transactions. It is not the purpose of this Revenue Ruling to determine the applicability of any of the listed rulings to past transactions.

A further review is being made of other old rulings. Therefore, failure to include any particular ruling in this or previous lists should not be construed as an indication that the ruling necessarily is determinative with respect to future transactions.

26 CFR 301.7805–1: Rules and regulations.

Nonretroactive application of ruling relating to the sale of by-products by an exempt farmers' cooperative association. See Rev. Rul. 69–417, page 132.

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26 CFR 301.7805–1: Rules and regulations.

Prospective application of Revenue Ruling relating to an employees' pension plan that provides that benefits thereunder will be offset by an amounts received under a profit-sharing plan maintained concurrently for the same employees. See Rev. Rul. 69–502, page 89.

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26 CFR 301.7805–1: Rules and regulations.

Whether the tax imposed by section 4061(b)(1) of the Code on separate sales of accessorial equipment for taxable tank bodies will be applied retroactively. See Rev. Rul. 69–567, page 204.

26 CFR 301.7805–1: Rules and regulations.

Prospective application of Revenue Ruling relating to information returns, Forms 1099 and 1096, with respect to payments made to suppliers of services under health, accident, and sickness insurance plans or medical assistance programs. See Rev. Rul. 69–595, page 242.

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26 CFR 301.7805–1: Rules and regulations.

Whether the manufacturers excise tax applies to the use of a foreign-made automobile imported by a United States resident. See Rev. Rul. 69–598, page 211.

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26 CFR 301.7805–1: Rules and regulations.

Prospective application of Revenue Ruling relating to the qualification of a federated farmers' cooperative for exemption under section 521 of the Code. See Rev. Rul. 69–651, page 135.

Part III

Alcohol, Tobacco, and Firearms 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 D—Beer

Section 5053.—Exemptions

26 CFR 245.170: General.

Listing of foreign countries for which beer may be withdrawn without payment of tax for use as supplies on aircraft. See Rev. Proc. 69–15, page 287.

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26 CFR 245.170: General.

Listing of foreign countries for which beer may be withdrawn without payment of tax for use as supplies on aircraft. See Rev. Proc. 69–25, page 307.

Section 5055.—Drawback of Tax

26 CFR 252.21: General.

Listing of foreign countries for which beer may be withdrawn with benefit of drawback for use as supplies on aircraft. Rev. Proc. 69–25, page 287.

Subpart E. General Provisions

Section 5062.—Refund and Drawback in Case of Exportation

26 CFR 252.23: Reciprocating foreign countries.

Listing of foreign countries for which distilled spirits or wines may be withdrawn with benefit of drawback for use as supplies on aircraft. See Rev. Proc. 69–15, page 287.

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26 CFR 252.23: Reciprocating foreign countries.

Listings of foreign countries for which distilled spirits or wines may be withdrawn with benefit of drawback for use as supplies on aircraft. See Rev. Proc. 69–25, page 307.

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26 CFR 252.171: General.

Procedures for obtaining certification as to the authenticity of straight bourbon whiskey being exported to member States of the European Economic Community. See Rev. Proc. 69–28, page 309.

Subpart D. Wholesale Dealers

Section 5114.—Records

26 CFR 194.221: General requirements as to distilled spirits.
(Also Section 5555; 194.225, 194.226.)

T.D. 7014 [1]

Title 26.—Internal Revenue.—Chapter I, Subchapter E, Part 194—Liquor Dealers

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 17, 1969, a notice of proposed rule making to amend 26 CFR Part 194 was published in the Federal Register (34 F.R. 755). In accordance with the notice, interested persons were afforded an opportunity to submit written comments or suggestions pertaining thereto. After consideration of all relevant matter presented and further study of the proposed amendments, the following regulations are hereby adopted.

PARAGRAPH 1. Section 194.221 is amended by deleting specific instructions for preparing records and reports as such instructions are contained in, or have been transferred to, other sections. As amended, § 194.221 reads as follows:

§ 194.221 General requirements as to distilled spirits.

Except as provided in §§ 194.223 and 194.224, every wholesale dealer in liquors shall, daily, prepare records of the physical receipt and disposition, as prescribed in §§ 194.225 and 194.226, respectively, of distilled spirits by him, and shall, daily, prepare a recapitulation record, as prescribed in § 194.230, showing the total wine gallons if in bottles, or proof gallons if in packages, of distilled spirits received and disposed of during the day.

(72 Stat. 1342, 1395; 26 U.S.C. 5114, 5555)

PAR. 2. Section 194.225 is amended by prescribing consignors' invoices (or the consignees' memorandum receiving records) and credit memorandums as the record of receipt. As amended, § 194.225 reads as follows:

§ 194.225 Records of receipt.

(a) *Information required.* Every wholesale dealer in liquors shall maintain a daily record of the physical receipt of each individual lot or shipment of distilled spirits, which record shall show (1) name and address of consignor, (2) date of receipt, (3) brand name, (4) name of producer or bottler, except that this may be omitted if the dealer keeps available for inspection a separate list or record identifying the producer or bottler with the brand name, (5) kind of spirits, except that this may be omitted if the dealer keeps available for inspection a separate list or record identifying "kind" with the brand name, (6) quantity actually received (showing number of packages, if any, and number of cases by size of bottle, and explaining any difference from the quantity shown on the commercial papers covering the

[1] The publication of the Treasury Decision in 34 F.R. 8911, dated June 4, 1969, contains (1) instructions for modifying the notice of proposed rulemaking published in 34 F.R. 755, dated January 17, 1969, 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.

shipment), (7) the serial numbers of packages, and (8) where required in writing by the assistant regional commissioner, serial numbers of cases. Where the recording of serial numbers is required, they may, if desired, be shown on supporting documents attached to the record of receipt. Additional information may also be shown.

(b) *Form of record.* The record prescribed by paragraph (a) of this section shall consist of consignors' invoices (or, where such invoices are not available on the day the shipment is received, memorandum receiving records prepared on the day of receipt of the distilled spirits), and credit memorandums covering distilled spirits returned to the dealer, which contain all required information. Each such invoice (or memorandum receiving record) and credit memorandum shall be numbered by the consignee dealer in the sequence of the physical receipt of the spirits covered thereby. The consignee dealer may start a new series of such numbers annually, or on approval of the assistant regional commissioner, more frequently.

(72 Stat. 1342, 1395; 26 U.S.C. 5114, 5555)

PAR. 3. Section 194.226 is amended by prescribing the wholesale dealer's invoices (or memorandum shipping records) as the records of disposition. As amended, § 194.226 reads as follows:

§ 194.226 Records of disposition.

(a) *Information required.* Every wholesale dealer in liquors shall prepare a daily record of the physical disposition of each individual lot of distilled spirits, which record shall show (1) name and address of consignee, (2) date of disposition, (3) brand name, (4) kind of spirits, except that this may be omitted if the dealer keeps available for inspection a separate list or record identifying "kind" with the brand name, (5) number of packages, if any, and number of cases by size of bottle, (6) the serial numbers of packages, and (7) where required in writing by the assistant regional commissioner, serial numbers of cases. Where the recording of serial numbers is required, they may, if desired, be shown on supporting documents attached to the record of disposition. Additional information may also be shown.

(b) *Form of record.* The record prescribed by paragraph (a) of this section shall consist of the wholesale dealer's invoices (or, where such invoices are not available at the time the spirits are removed, memorandum shipping records prepared at the time of removal of the distilled spirits) which contain all required information. Each such invoice (or memorandum shipping record) shall be preprinted with the name and address of the wholesale dealer in liquors and shall be serially numbered in consecutive order. The wholesale dealer may start a new series of such numbers annually, or, on approval of the assistant regional commissioner, more frequently.

(72 Stat. 1342, 1395; 26 U.S.C. 5114, 5555)

PAR. 4. Section 194.227 is amended with regard to the manner in which records of receipt and disposition will be canceled or corrected. As amended, § 194.227 reads as follows:

§ 194.227 Canceled or corrected records.

Entries on the records of receipt and disposition prescribed by §§ 194.225 and 194.226 shall not be erased or obliterated. Correction or deletion of any entry shall be accomplished by drawing a line through such entry, and making appropriate correction or explanation. If a wholesale dealer in liquors voids an invoice for any reason, the "Government File Copy" prescribed in § 194.240 shall be marked "Canceled" and be filed as provided in that section; all remaining copies of the voided invoice shall be destroyed or similarly canceled and filed. If a new invoice is prepared, the serial number thereof shall be noted on all retained copies of the canceled invoice.

(72 Stat. 1342; 26 U.S.C. 5114)

PAR. 5. Section 194.228 is amended to provide that a wholesale dealer may continue to use his previously approved records of receipt and disposition, and a related change is made in the section heading. As amended, § 194.228 reads as follows:

§ 194.228 Previously prescribed or approved records of receipt and disposition.

A wholesale dealer in liquors may continue to use records of receipt and disposition in a format previously prescribed, or approved for him, provided he gives written notice of such intent to the assistant regional commissioner. Such records shall show the information required by paragraph (a) of § 194.225 or paragraph (a) of § 194.226, as applicable. Such records shall be preprinted with the name and address of the wholesale dealer. Each sheet or page shall bear a preprinted serial number, or page serial numbers may be affixed in unbroken sequence during the preparation or processing of the record. A serial number shall not be duplicated within a period of six months.

(72 Stat. 1342; 26 U.S.C. 5114)

PAR. 6. Section 194.229 is amended to provide that the Director, Alcohol and Tobacco Tax Division, may also authorize variations in type of record, and to recognize the use of data processing equipment. As amended, Section 194.229 reads as follows:

§ 194.229 Variations in format, or preparation, of records.

(a) *Authorization.* The Director may approve variations in the type and format of records of receipt and disposition, or in the methods of preparing such records, where it is shown that variations from the requirements are necessary in order to use data processing equipment, other business machines, or existing accounting systems, and will not (1) unduly hinder the effective administration of this part, (2) jeopardize the revenue, or (3) be contrary to any provision of law. A dealer who proposes to employ such a variation shall submit written application so to do, in triplicate, to

the assistant regional commissioner. Such application shall describe the proposed variations and set forth the need therefor. The assistant regional commissioner will determine the need for the variations, and whether approval thereof would unduly hinder the effective administration of this part or result in jeopardy to the revenue. The assistant regional commissioner will forward two copies of the application to the Director together with a report of his findings and his recommendation. Variations in type and format of records or methods of preparation shall not be employed until approval is received from the Director.

(b) *Requirements.* Any information required by this part to be kept or filed is subject to the provisions of law and this part relating to required records and reports, regardless of the form or manner in which kept or filed.

PAR. 7. Section 194.230 is amended to provide that assistant regional commissioners, alcohol and tobacco tax, may authorize the preparation of recapitulation records at intervals less frequent than daily. As amended, § 194.230 reads as follows:

§ 194.230 Recapitulation records.

Every wholesale dealer in liquors shall, daily, prepare a recapitulation record showing the total quantities of distilled spirits received and disposed of during the day: *Provided,* That, upon application, and on his finding that preparation of the recapitulation daily is not necessary to law enforcement or protection of the revenue, the assistant regional commissioner may authorize a dealer to prepare such record less frequently until otherwise notified. The assistant regional commissioner's authorization shall specify the intervals at which the recapitulation shall be prepared and shall provide that the authorization may be withdrawn if, in the opinion of the assistant regional commissioner, preparation of a daily recapitulation by the dealer is necessary to law enforcement or to protection of the revenue.

PAR. 8. The center heading "Daily and Monthly Reports" immediately preceding § 194.231 is deleted.

PAR. 9. In order to provide for the filing of the wholesale liquor dealer's report, Form 338, semiannually instead of monthly and to delete extraneous material, § 194.232 is deleted and §§ 194.231 and 194.233 are amended to read as follows:

§ 194.231 Wholesale liquor dealer's semiannual report, Form 338.

As of the close of business on June 30 and December 31 of each year, every wholesale dealer in liquors who is required to keep the records prescribed in § 194.221 shall prepare, on Form 338, in duplicate, a report showing the total quantities of distilled spirits received and disposed of during the 6-month period ending on such day. If there were no receipts or disposals of distilled spirits during the period, Form 338 shall be prepared showing the quantity on hand the first day of the period and the quantity on hand the last day of the period and marked "No transactions during period." The original of Form 338 shall be filed with the assistant regional commissioner not later than the 10th day of the month succeeding the period for which rendered, and the copy shall be retained by the dealer.

(72 Stat. 1342; 26 U.S.C. 5114)

§ 194.232 [Deleted.]

§ 194.233 Discontinuance of business.

When a wholesale dealer in liquors discontinues business as such, he shall render Form 338, covering transactions from the first day of the 6-month period (referred to in § 194.231) in which business is discontinued, through the date of such discontinuance, mark such report "Final", and file the form with the assistant regional commissioner within 10 days of the date of such discontinuance.

(72 Stat. 1342; 26 U.S.C. 5114)

PAR. 10. Section 194.234 is amended to include the waiver of filing daily or periodic reports on Forms 52A and 52B, transferred from §194.221, and to simplify the instructions for filing such reports. As amended, § 194.234 reads as follows:

§ 194.234 Daily reports, Forms 52A and 52B.

Except as provided in §§ 194.223 and 194.224, every wholesale dealer in liquors shall prepare and submit, daily, a report on Form 52A of all distilled spirits received by him, and on Form 52B of all distilled spirits disposed of by him. The reports shall be filed with the assistant regional commissioner or other officer designated by him. Each report shall bear the following declaration signed by the dealer or his authorized agent:

I declare under the penalties of perjury that this report, consisting of — pages, has been examined by me and to the best of my knowledge and belief is a true, correct, and complete report of all the transactions which occurred during the period covered thereby, and each entry therein is correct.

If in any case the assistant regional commissioner shall so authorize, the reports, in lieu of being filed daily, may be filed for such periods and at such times as he may deem necessary in the interest of the Government, or, upon application, and a finding by the assistant regional commissioner that such reporting is not necessary to law enforcement or protection of the revenue, he may relieve a dealer from the requirement of preparing and submitting such daily or periodic reports on Forms 52A and 52B until otherwise notified.

(68A Stat. 749, 72 Stat. 1342; 26 U.S.C. 6065, 5114)

10a. Section 194.237 is amended to conform the requirements regarding the reporting of serial numbers to the liberalized amendments to §§ 194.225 and 194.226. As amended, § 194.237 reads as follows:

§ 194.237 Serial numbers of containers.

Serial numbers of packages of distilled spirits received, or disposed of, shall be reported on Form 52A or Form 52B unless the omission of such serial numbers is specifically author-

ized by the assistant regional commissioner. Serial numbers of cases of distilled spirits received, or disposed of, shall be reported on Form 52A or Form 52B by any wholesale dealer who has been required, pursuant to §§ 194.225 and 194.226, to record such serial numbers in his records of receipt and disposition.

PAR. 11. Section 194.238 is amended to conform to the change in the period for which Form 338 is filed, as set forth in § 194.231, to delete extraneous material, and to make conforming changes in section references. As amended, § 194.238 reads as follows:

§ 194.238 Requirements when wholesale dealer in liquors maintains a retail department.

(a) When a wholesale dealer in liquors maintains a separate department on his premises for the retailing of distilled spirits, he shall, except as provided in paragraph (b) of this section, at the time distilled spirits are transferred to the retail department, prepare a record, as prescribed in § 194.226, showing such disposition. Where it is necessary in the filling of an order to transfer distilled spirits from the retail department to the wholesale department, a record showing receipt in the wholesale department shall be prepared as prescribed in § 194.225, and the entire wholesale sale shall be entered on a record of disposition in the same manner as any other disposition from the wholesale department. The provisions of this subpart relating to submission of reports on Forms 52A and 52B are applicable to all transfers between wholesale and retail departments. The retail department need not be maintained in a separate room, or be partitioned off from the wholesale department, but the retail department shall in fact be separate from the wholesale department.

(b) Where retail sales of distilled spirits normally represent 90 percent or more of the volume of distilled spirits sold, the dealer may, in lieu of the records required by § 194.225 keep records as prescribed in § 194.239 for all retail dealers in liquors, and all distilled spirits at the premises may be considered as having been received in the dealer's retail department. In addition, as prescribed by § 194.226, he shall prepare records of disposition on all distilled spirits sold at wholesale, and shall prepare recapitulation records of such spirits, as prescribed in § 194.230. Distilled spirits which have been considered as having been received in the retail department, and which are involved in a wholesale transaction, shall be considered as having been transferred to the wholesale department at the time of sale. The semiannual report on Form 338 shall be submitted in accordance with the provisions of § 194.231, even if there have been no wholesale transactions in distilled spirits. Unless relieved of the requirement, pursuant to application under § 194.234, the dealer shall submit daily or periodic reports on Forms 52A and 52B of all his wholesale liquor dealer transactions in distilled spirits. The dealer's wholesale department need not be maintained in a separate room or be partitioned off from the retail department.

(72 Stat. 1342, 1345, 1395; 26 U.S.C. 5114, 5124, 5555)

PAR. 13. Section 194.240 is amended by changing the section heading to include reference to the time of filing specified records and to delete the word "looseleaf," and by making a clarifying restatement of the text. As amended, § 194.240 reads as follows:

§ 194.240 Time and manner of filing records of receipt and disposition.

One legible copy of each record of receipt and each record of disposition required by this subpart shall be marked or stamped as "Government File Copy," and shall be filed chronologically, and in numerical sequence within each date. Where the chronological filing of the record of disposition disarranges the numerical sequence to such an extent that the sequence of numbers cannot be readily traced, a control record shall be maintained by the wholesale dealer, which shall key the numerical sequence of the records to their respective dates. Government file copies shall be filed not later than the close of the business day next succeeding that on which the transaction occurred. Separate files shall be maintained for records of receipt and for records of disposition. Supporting documents such as delivery receipts, and bills of lading may be filed in accordance with the wholesaler's customary practice.

(72 Stat. 1342; 26 U.S.C. 5114)

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).)

WILLIAM H. SMITH,
Acting Commissioner of Internal Revenue.

Approved May 28, 1969.

EDWIN S. COHEN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on June 3, 1969; 8:48 a.m., and published in the issue of the Federal Register for June 4, 1969, 34 F.R. 8911)

Subchapter C. Operation of Distilled Spirits Plants

Part I. General Provisions

Section 5206.—Containers

26 CFR 201.517: Kind of spirits or wine. (Also Section 5(e); 27 CFR 5.21, 5.35.)

Under certain conditions neutral spirits may be redesignated vodka and bottlers may, for labeling purposes, be considered distillers or producers; Revenue Rulings 55–594, 56–207, 58–122, 58–253, 58–336, 58–415, 58–560, 65–115, 65–122, declared obsolete.

Rev. Rul. 69–496

Treasury Decision 6973, C.B., 1968–2, 648, in part, revised the standard of identity for vodka by amendment of 27 CFR 5.21(a) effective December 1,

1968, and established a standard for flavored vodka by addition of paragraph (j) to 27 CFR 5.21 effective July 1, 1969.

In view of the amendments to 27 CFR 5.21, the Internal Revenue Service has reviewed current revenue rulings pertaining to vodka and flavored vodka to determine which rulings are no longer consistent with the provisions of 27 CFR 5.21, as amended. The Service has also considered the question of redesignation of eligible neutral spirits as vodka and the conditions under which bottlers may use on labels of vodka the terms "distilled by," "produced by," "prepared by," or "bottled by."

Under the provisions of 26 CFR 201.517(b) relating to marks and brands to be placed on containers of distilled spirits, eligible neutral spirits may, before removal from bonded premises, be redesignated as vodka upon approval of the Assistant Regional Commissioner, Alcohol, Tobacco and Firearms. Also, vodka (under similar circumstances) may be redesignated as neutral spirits.

In view of the definition for vodka contained in 27 CFR 5.21, as amended, it has been determined that neutral spirits which are without distinctive character, aroma, taste, or color may be redesignated as vodka by the proprietor of a distilled spirits plant, after withdrawal of such spirits from bond and before the completion of the bottling thereof. Also, vodka on bottling premises may be redesignated as neutral spirits. In either case, it would not be necessary to submit Form 27–B Supplemental, Formula and Process for Rectified Products, for approval.

The labeling provisions of 27 CFR Part 5 will permit only the term "bottled by" to appear on labels of bottled vodka which, without treatment, has been so redesignated from neutral spirits. Labels carrying this legend which are covered by outstanding certificates on Form 1649, Application For and Certification of Label Approval, may continue to be used without further endorsement of the applicable Forms 1649, even though the formulas to which they originally related are no longer being used. A bottler who actually redistills neutral spirits in the production of vodka or who is the proprietor of the bonded production facilities where the eligible neutral spirits were distilled may use on labels the term "distilled by." A bottler who treats neutral spirits (whether or not such neutral spirits are eligible to be described as vodka) on bottling premises or on production premises (1) with at least one ounce of activated carbon for each 100 wine gallons of neutral spirits or (2) by any other approved method of purifying or refining neutral spirits for the purpose of producing vodka may indicate on labels that the vodka was "produced by" him. However, where neutral spirits are given any lesser treatment than that indicated in (1) or (2) above, the bottler may show on labels only that the vodka was "bottled by" or "prepared by" him. In such case, the term "produced by" is not authorized. In any case, treatment on bottling premises must be approved pursuant to Form 27–B Supplemental. Treatment on production premises must be described in the Statement of Process submitted on Form 2607, Registration of Distilled Spirits Plant. In addition, if two or more lots of neutral spirits (each eligible to be designated vodka without treatment) are mingled, the resultant product may be redesignated as vodka. However, such mingling would not be regarded as an act of production.

On the basis of the review which has been made, the following Revenue Rulings pertaining to vodka and to flavored vodka are hereby declared obsolete:

55–594, C.B. 1955–2, 700
58–122, C.B. 1958–1, 613
58–336, C.B. 1958–1, 588
58–560, C.B. 1958–2, 958
56–207, C.B. 1956–1, 811
58–253, C.B. 1958–1, 581
58–415, C.B. 1958–2, 985
65–115, C.B. 1965–1, 581
65–122, C.B. 1965–1, 584

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 252.23: Reciprocating foreign countries.

Listing of foreign countries for which distilled spirits may be withdrawn without payment of tax for use as supplies on aircraft. See Rev. Proc. 69–15, page 287.

26 CFR 252.91: General.

Procedures for obtaining certification as to the authenticity of straight bourbon whiskey being exported to member States of the European Economic Community. See Rev. Proc. 69–28, page 309.

Subpart D. Denaturation

Section 5242.—Denaturing Materials

26 CFR 212.16: Formula No. 1. (Also 212.65.)

Substitute formulations are authorized in the production of specially denatured alcohol Formula No. 1.

Rev. Rul. 69–483

26 CFR 212.16 prescribes the use of wood alcohol as the denaturant to be used in specially denatured alcohol Formula No. 1. Because of the shortage of denaturing grade wood alcohol, the Director, Alcohol, Tobacco and Firearms Division, has been requested to provide for the use of substitute denaturants in the production of that formula.

Accordingly, under the provisions of 26 CFR 212.65, substitute denaturants are authorized for use in lieu of the five gallons of wood alcohol specified for specially denatured alcohol Formula No. 1. These are as follows:

Option (1) Four gallons methyl alcohol and 1/8 avoirdupois ounce denatonium benzoate, N.F. (Bitrex); or

Option (2) Four gallons methyl alcohol and one gallon methyl isobutyl ketone.

26 CFR 212.65: General.

Authorization for substitute denaturants for specially denatured alcohol Formula No. 1. See Rev. Rul. 69–483, page 273.

Subchapter F. Bonded and Taxpaid Wine Premises

Part II. Operations

Section 5362.—Removals of Wine From Bonded Wine Cellars

26 CFR 240.670: General.

Listing of foreign countries for which wines may be withdrawn without payment of tax for use as supplies on aircraft. See Rev. Proc. 69–15, page 287.

Section 5373.—Wine Spirits

26 CFR 240.630: General.

Salted wine lees and rectified special natural wine may not be used as distilling material for wine spirits.

Rev. Rul. 69–521

The Internal Revenue Service has been asked whether nonbeverage or salted wine lees and rectified special natural wine may be used as distilling material for wine spirits.

Section 5373 of the Internal Revenue Code of 1954 states in part that wine spirits authorized to be used in wine production shall be brandy or wine spirits produced exclusively from fresh or dried fruit, or their residues; the wine or wine residues therefrom; or, under certain conditions, special natural wine. Since nonbeverage or salted wine lees and rectified special natural wine are not composed exclusively of any of the foregoing, they may not be used as distilling material for wine spirits within the contemplation of section 5373.

In addition to the above barring its use as distilling material, rectified special natural wine by reason of its being subject (on distilled spirits plant premises) to treatment not authorized on bonded winery premises would not be considered a special natural wine eligible for return to bonded winery premises as unmerchantable wine under the authority of section 5044 of the Code.

Part III. Cellar Treatment and Classification of Wine

Section 5382.—Cellar Treatment of Natural Wine

26 CFR 240.524: Finishing of wine. (Also 240.1051, 240.1052.)

Veltol Plus may be used in an amount not exceeding 100 parts per million to stabilize and smooth wine.

Rev. Rul. 69–626

The Internal Revenue Service has been asked whether Veltol Plus may be used as a stabilizing and smoothing agent in the treatment of wine.

The use of Veltol Plus as a stabilizing agent to stabilize and smooth wine in an amount not exceeding 100 parts per million is considered as being consistent with good commercial practice within the provisions of 26 CFR 240.524.

Winemakers desiring to use this stabilizing and smoothing agent in the treatment of wine may obtain approval of the Assistant Regional Commissioner, Alcohol, Tobacco and Firearms, by filing a notice pursuant to the provisions of 26 CFR 240.1052.

26 CFR 240.1051: Materials authorized for treatment of wine.

Use of Veltol Plus to stabilize and smooth wine. See Rev. Rul. 69–626, this page.

26 CFR 240.1052: Notice.

Use of Veltol Plus to stabilize and smooth wine. See Rev. Rul. 69–626, this page.

Subchapter I. Miscellaneous General Provisions

Section 5555.—Records, Statements, and Returns

26 CFR 194.225: Records of receipt.

Wholesale liquor dealers' record and reporting requirements of receipt and disposition of distilled spirits. See T.D. 7014, page 269.

26 CFR 194.226: Records of disposition.

Wholesale liquor dealers' record and reporting requirements of receipt and disposition of distilled spirits. See T.D. 7014, page 269.

Chapter 80. General Rules

Subchapter A. Application of Internal Revenue Laws

Section 7805—Rules and Regulations

26 CFR 252.104: Certificates of origin.

Procedures in executing certificates of origin covering spirits for export to Italy. See Rev. Proc. 69–23, page 305.

26 CFR 301.7805–1: Rules and regulations.

Provisions relating to certification of chemists and laboratories to analyze distilled spirits for exportation. See Rev. Proc. 69–22, page 304.

Federal Alcohol Administration Act

Section 5(e).—Unfair Competition and Unlawful Practices: Labeling

27 CFR 5.21: The standards of identity.

Redesignation of neutral spirits as vodka. See Rev. Rul. 69–496, page 272.

27 CFR 5.35: Name and address.

Labeling of neutral spirits redesignated as vodka See Rev. Rul. 69–496, page 272.

Subpart B.—Tobacco Matters Issued Under Chapter 52 of the Internal Revenue Code of 1954

Chapter 52. Cigars, Cigarettes, and Cigarette Papers and Tubes

Subchapter A. Definitions; Rates and Payment of Tax; Exemption from Tax; and Refund and Drawback of Tax

Section 5701.—Rate of Tax

26 CFR 270.21: Cigar tax rates. (Also 275.31) (Also Section 5723; 270.214, 275.73.)

Principles are specified for tax determination of large cigars removed prior to the effective date of a change in the retail price which would result in a change in the tax rate.

Rev. Rul. 69–470

Questions have been asked about the proper tax determination and package

class designation for large cigars removed subject to tax prior to the effective date of a change in the retail price which would result in a change in the tax rate imposed by section 5701, Internal Revenue Code of 1954.

Section 5701(a)(2) of the Code imposes a tax on large cigars at seven different rates based on the ordinary retail price at which the cigars are sold. Under section 5723 of the Code all cigars must be put up in packages that bear the required marks, labels, and notices. Implementing regulations in 26 CFR 270.214 and 275.73 require that packages of large cigars bear the appropriate tax class designation corresponding with the tax rate imposed on the cigars therein.

Under Section 5701 of the Code the primary responsibility for determining the proper tax rate for large cigars is the manufacturer's or importer's. Therefore, it is his responsibility to know at the time of removal the price at which his cigars will ordinarily be sold at retail and to determine the tax rate accordingly. The following principles apply where there is a change in the retail price which will cause a change in the tax rate.

The cigars the manufacturer or importer believed would be sold at the old price and which were removed in good faith at the old tax rate, considering all information which was or should have been available to him at the time of removal, would be considered properly tax determined (and the packages as bearing the proper class designation), even though some of these cigars might be sold at wholesale and retail at the new price.

Conversely, where the manufacturer or importer can reasonably know at the time of removal that cigars will be sold at retail at the new price, then the tax rate would be based on that new retail price, with the packages bearing the corresponding new class designation. This is true even if the removal takes place before the price change is announced or becomes effective. For example, price changes require advance planning; any cigars removed after the price-change decision is made which can logically be expected not to have been sold at retail before the retail price change becomes effective must be tax determined on the basis of the new retail price.

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26 CFR 275.31: Cigars.

Principles in determining proper tax rate for large cigars when retail price is changed. See Rev. Rul. 69–470, page 274.

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26 CFR 275.32: Cigarettes.

For tax applicable to the smoking product "bidi" manufactured in India. See Rev. Rul. 69–488, this page.

Section 5702.—Definitions

26 CFR 275.11: Meaning of terms. (Also Section 5701; 275.32.)

The smoking product "bidi" manufactured in India is subject to tax as a cigarette under section 5701(b) of the Code.

Rev. Rul. 69–488

Samples of several brands of a smoking product manufactured in India have been received with requests for advice as to the internal revenue tax applicable. The product is variously known as "bidi," "beedi," and "biri."

All samples examined were tapered or cone shaped, two to three inches long, with tobacco flakes as the filler, and wrapped in a leaf held together by a thread. The wrapper leaf was not tobacco. Some of the samples had a plastic holder affixed which could be easily removed. This allowed the product to be smoked either with or without the holder.

Section 5702(b) of the Internal Revenue Code of 1954 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)."

The samples of the smoking product examined are rolls of tobacco wrapped in a "substance not containing tobacco" as contemplated by section 5702(b) of the Code, and are accordingly held to be cigarettes as defined in that section and subject to the tax imposed on cigarettes by section 5701(b) upon importation into the United States.

Section 5704.—Exemption From Tax

26 CFR 290.200: Transfers between factories and export warehouses.

Procedures to be followed in documenting receipt of tobacco articles delayed during transfer between export warehouses and between factories and export warehouses. See Rev. Proc. 69–27, page 309.

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26 CFR 290.201: Return to manufacturer or customs warehouse proprietor.

Procedures to be followed in documenting receipt of tobacco articles delayed during transfer in bond from an export warehouse to a factory. See Rev. Proc. 69–27, page 309.

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26 CFR 290.210: Return of shipment to factory or export warehouse.

Tobacco products returned to the United States without being delivered to the purchasing aircraft passenger or unladen at the port of destination are not considered exported.

Rev. Rul. 69–599

The question has been raised as to whether tobacco products can be treated as not having been exported and can be returned to the export warehouse under the following circumstances:

1. Tobacco products are purchased by a passenger prior to boarding an aircraft for delivery to him when beyond the jurisdiction of the internal revenue laws of the United States or at the port of destination.

2. The tobacco products are not delivered to the passenger and are not unladen at the port of destination but

remain on the aircraft and are returned to the United States.

The regulations, 26 CFR 290.210, provide that an export warehouse proprietor may return to his export warehouse tobacco products previously removed therefrom for export but not yet exported. Tobacco products which have been removed under 26 CFR Part 290 for delivery to a vessel or aircraft entitled to receive them as ships' supplies are considered to have been "exported" when the vessel or aircraft, with the tobacco products aboard, has proceeded beyond the jurisdiction of the internal revenue laws of the United States (i.e., beyond the three-mile limit or international boundary, as the case may be). Likewise, tobacco products removed without payment of tax for delivery to an exporting carrier for exportation are considered to have been exported when the exporting carrier, with the tobacco products aboard, has proceeded beyond the three-mile limit or international boundary. Tobacco products removed under the circumstances set forth in the first paragraph do not belong in either of these categories since they are removed neither for ships' supplies nor for exportation in the normally accepted sense (i.e., for uniting with the mass of things belonging to some foreign country).

Therefore, tobacco products removed from an export warehouse and laden on an aircraft for delivery to a specific passenger who purchased them prior to boarding are not considered exported if they are not delivered to the passenger and are not unladen at the port of destination in a foreign country, Puerto Rico, the Virgin Islands, or a possession of the United States, but remain on the aircraft and are returned to the United States without fulfilling the intent for which they were removed. Under these conditions the tobacco products are considered as not having been exported and may be returned to the export warehouse as provided in 26 CFR 290.210.

Subchapter C. Operations by Manufacturers and Importers of Tobacco Products and Cigarette Papers and Tubes and Export Warehouse Proprietors

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Section 5723.—Packages, Marks, Labels, Notices, and Stamps

26 CFR 270.214: Notice for cigars.

Determination of proper class designation for packages of large cigars when retail price is changed. See Rev. Rul. 69–470, page 274.

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26 CFR 275.73: Notice for cigars.

Determination of proper class designation for packages of large cigars when retail price is changed. See Rev. Rul. 69–470, page 274.

Part IV. Treaties

Tax Convention

United States–Germany Income Tax Convention

The surcharge imposed by Germany on income and corporation taxes under the Law of December 21, 1967, is a creditable tax within the meaning of Article XV(1) of the United States–Germany Income Tax Convention.

Rev. Rul. 69–593

The Law of December 21, 1967, enacted by the Federal Republic of Germany, imposes a surcharge on its income tax and its corporation tax. Article I(1)(b) of 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, as amended, C.B. 1966–1, 360, identifies the Federal Republic taxes as including the income tax and corporation tax. Article XV(1) of the Convention, as amended, provides for a credit against United States tax for Federal Republic taxes paid as a means of avoiding double taxation.

Articles XVII(2) and XIX(2) of the Convention confer upon the competent authorities of the United States and Germany the responsibility of directly implementing and effecting the provisions of the Convention. Pursuant to those Articles of the Convention, the Internal Revenue Service and the German Ministry of Finance have agreed by an exchange of letters that the surcharge imposed on the income tax and corporation tax by the Law of December 21, 1967, is a creditable tax within the meaning of Article XV (1) of the Convention, as amended.

Part V. Administrative, Procedural, and Miscellaneous Matters

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Part V. Administrative, Procedural, and Miscellaneous Matters

Delegation Order No. 8 (Rev. 3) (Effective October 20, 1969)

Authority to sign agreements as to liability for Personal Holding Company Tax

1. The authority granted to the Commissioner of Internal Revenue and District Directors by 26 CFR 301.7701–9 and 26 CFR 1.547–2 to enter into agreements relating to liability for personal holding company tax, is hereby delegated to the following officials:

(a) Assistant Regional Commissioners (Appellate),

(b) Chiefs, Appellate Branch Offices,

(c) Associate Chiefs, Appellate Branch Offices,

(d) Assistant Chiefs, Appellate Branch Offices,

(e) Director of International Operations,

(f) Assistant District Directors, and

(g) Chiefs of District Audit Divisions.

2. This authority may be redelegated only by District Directors and the Director of International Operations, who may redelegate to the Chief of Review Staff (or to the Chief of Technical Branch where that position has been established); Chief of Conference Staff; and to Revenue Agents (Reviewers or Conferees) not lower than GS–11.

3. This Order supersedes Delegation Order No. 8 (Rev. 2) issued February 28, 1968 [C.B. 1968–1, 735].

RANDOLPH W. THROWER,
Commissioner.

(Filed by the Office of the Federal Register on October 22, 1969; 8:49 a.m., and published in the issue of the Federal Register for October 23, 1969, 34 F.R. 17200)

Delegation Order No. 35 (Rev. 4) (Effective October 20, 1969)

Agreements as Determinations under section 1313(a)(4) of the Internal Revenue Code of 1954

1. Pursuant to the authority granted to the Commissioner of Internal Revenue and District Directors by 26 CFR 301.7701–9 and 26 CFR 1.1313(a)–4, the authority to enter into agreements pursuant to section 1313(a)(4), Internal Revenue Code of 1954, relating to agreements treated as determinations, is hereby delegated to the following officials:

(a) Assistant Regional Commissioners (Appellate),

(b) Chiefs, Appellate Branch Offices,

(c) Associate Chiefs, Appellate Branch Offices,

(d) Assistant Chiefs, Appellate Branch Offices,

(e) Director of International Operations,

(f) Assistant District Directors, and

(g) Chiefs of District Audit Divisions.

2. This authority may be redelegated only by District Directors and the Director of International Operations, who may redelegate to the Chief of Review Staff (or to the Chief of Technical Branch where that position has been established); Chief of Conference Staff; to Revenue Agents (Reviewers or Conferees) not lower than GS–11 for field audit cases; and to Revenue agents (Reviewers or Conferees) and Tax Technicians (Reviewers or Conferees) not lower than GS–9 for office audit cases.

3. This order supersedes Delegation Order No. 35 (Rev. 3) issued February 28, 1968 [C.B. 1968–1, 736].

RANDOLPH W. THROWER,
Commissioner.

(Filed by the Office of the Federal Register on October 22, 1969; 8:49 a.m., and published in the issue of the Federal Register for October 23, 1969, 34 F.R. 17201)

Delegation Order No. 57 (Rev. 2) (Effective December 4, 1969)

Notice of Additional Inspection of Taxpayer's Books of Account Under Section 7605(b), Internal Revenue Code 1954

Pursuant to authority vested in the Commissioner of Internal Revenue by Section 3631 of the Internal Revenue Code of 1939 and Treasury Department Order No. 120, dated July 31, 1950, and continued in effect by Section 7851(b)(3) of the Internal Revenue Code of 1954, there is hereby delegated to each Regional Commissioner and to the Assistant Commissioner (Compliance), the authority to sign in his name, after investigation, the notice to a taxpayer, required by Section 7605(b) of the Internal Revenue Code of 1954, that an additional inspection of such taxpayer's books of account is necessary.

This authority may not be redelegated.

This order supersedes Delegation Order No. 57 (Rev. 1) [C.B. 1960–2, 920] issued November 2, 1960.

RANDOLPH W. THROWER,
Commissioner.

(Filed by the Office of the Federal Register on Dec. 9, 1969; 8:47 a.m., and published in the issue of the Federal Register for Dec. 10, 1969, 34 F.R. 19517)

Delegation Order No. 66 (Rev. 3) Chief Counsel's Order No. 1958–11 (Rev. 3) (Effective October 20, 1969)

Authorities of Regional Appellate Division and of Regional Council 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 does not agree to 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 and requests consideration by the Regional Appellate Division, 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 represent the Regional Commissioner in the determination of tax liability in any 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 $100,000 and the determination of the Appellate Division does not involve a net deficiency or net overassessment in excess of $100,000.

(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 $100,000 and the basis of disposition does not involve a net deficiency or net overassessment in excess of $100,000.

(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 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; nor

(b) Act in any case in which a recommendation for criminal prosecution is pending, except with the concurrence of the Regional Counsel.

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 Commission (Appellate) may relinquish the jurisdiction of the Appellate Division by waiver to the office of that District Director. Similarly, the Assistant Regional Commissioner (Appellate) 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) Chapters 8, 15, 23, 26, or 27A;

(2) Subchapter B of Chapter 25;

(3) Parts 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, and supersede other prior instructions to the extent that such other prior instructions are inconsistent herewith.

8. This Order supersedes Delegation Order No. 66 (Rev. 2), Chief Counsel's Order No. 1958–11 (Rev. 2),

issued February 19, 1968 [C.B. 1968–1, 737].

RANDOLPH W. THROWER,
Commissioner.
K. MARTIN WORTHY,
Chief Counsel.

(Filed by the Office of the Federal Register on October 22, 1969; 8:49 a.m., and published in the issue of the Federal Register for October 23, 1969, 34 F.R. 17201)

Delegation Order No. 75 (Rev. 3) (Effective June 27, 1969)

Authority of Regional Appellate Division in Offers in Compromise

Pursuant to the authority vested in the Commissioner of Internal Revenue by Treasury Department Order No. 150–25 dated June 1, 1953, as amended by Order No. 180 dated November 17, 1953, and Order No. 150–36 dated August 17, 1954 [C.B. 1954–2, 733], 26 CFR 301.7122–1 and 26 CFR 301.7701–9, it is hereby ordered:

1. Each Assistant Regional Commissioner (Appellate), and each Chief and Associate Chief, Appellate Branch Office, is authorized to determine the disposition to be made of any offer in compromise submitted under the provisions of section 7122 of the Internal Revenue Code of 1954, in which (a) the proponent does not agree with the rejection or proposed rejection of the offer in the district office, the Office of International Operations or a Service Center and requests regional Appellate Division consideration or (b) the liability was previously determined by a regional Appellate Division and the offer is based in whole or in part on doubt as to liability. Each Assistant Chief, Appellate Branch Office, is authorized to determine the disposition to be made of any such offer in compromise in which the unpaid amount of tax (including any interest, penalty, additional amount or addition to the tax) is $50,000 or less.

2. A determination by regional Appellate Division officials to accept an offer (other than one involving specific penalties only) pursuant to paragraph 1. above will be subject to my approval if the unpaid amount of tax (including any interest, penalty, additional amount or addition to the tax) is $100,000 or more.

3. The authorities delegated herein may not be redelegated and are not applicable to cases arising under tax laws relating to wagering, narcotics, marihuana, alcohol, tobacco or firearms (other than firearms taxes imposed by sections 4181 and 4182 of the Internal Revenue Code of 1954 and sections 2700 and 3407 of the Internal Revenue Code of 1939) or to offer in compromise coming within the jurisdiction of the Chief Counsel under existing procedures, rules or delegations.

4. This order supersedes Delegation Order No. 75 (Rev. 2) [C.B. 1963–2, 732], issued June 14, 1963.

Effective June 27, 1969.

RANDOLPH W. THROWER,
Commissioner.

(Filed by the Office of the Federal Register on June 30, 1969; 8:49 a.m., and published in the issue of the Federal Register for July 1, 1969, 34 F.R. 11108)

Delegation Order No. 75 (Rev. 4) (Effective October 20, 1969)

Authority of Regional Appellate Division in Offers in Compromise

Pursuant to the authority vested in the Commissioner of Internal Revenue by Treasury Department Order No. 150–25, dated June 1, 1953, as amended by Order No. 180, dated November 17, 1953, and Order No. 150–36, dated August 17, 1954 [C.B. 1954–2, 733], 26 CFR 301.7122–1 and 26 CFR 301.7701–9, it is hereby ordered:

1. Each Assistant Regional Commissioner (Appellate), and each Chief and Associate Chief, Appellate Branch Office, is authorized to determine the disposition to be made of any offer in compromise submitted under the provisions of section 7122 of the Internal Revenue Code of 1954, in which (a) the proponent does not agree with the rejection or proposed rejection of the offer in the district office, the Office of International Operations or a Service Center and requests regional Appellate Division consideration or (b) the liability was previously determined by a regional Appellate Division and the offer is based in whole or in part on doubt as to liability. Each Assistant Chief, Appellate Branch Office, is authorized to determine the disposition to be made of any such offer in compromise in which the unpaid amount of tax (including any interest, penalty, additional amount or addition to the tax) is less than $100,000.

2. A determination by regional Appellate Division officials to accept an offer (other than one involving specific penalties only) pursuant to paragraph 1. above will be subject to my approval if the unpaid amount of tax (including any interest, penalty, additional amount or addition to the tax) is $100,000 or more.

3. The authorities delegated herein may not be redelegated and are not applicable to cases arising under tax laws relating to wagering, narcotics, marihuana, alcohol, tobacco or firearms (other than firearms taxes imposed by sections 4181 and 4182 of the Internal Revenue Code of 1954 and sections 2700 and 3407 of the Internal Revenue Code of 1939) or to offers in compromise coming within the jurisdiction of the Chief Counsel under existing procedures, rules or delegations.

4. This Order supersedes Delegation Order No. 75 (Rev. 3), issued June 27, 1969 [this page].

RANDOLPH W. THROWER,
Commissioner.

(Filed by the Office of the Federal Register on October 22, 1969; 8:49 a.m., and published in the issue of the Federal Register for October 23, 1969, 34 F.R. 17202)

Delegation Order No. 77 (Rev. 3) (Effective October 20, 1969)

Authority to issue statutory notices of deficiency

1. The authority granted to the Commissioner of Internal Revenue, Assistant Regional Commissioners (Appellate) and District Directors by 26 CFR 301.7701–9, 26 CFR 301.6212–1 and 26 CFR 301.6861–1 to

sign, and send to the taxpayer by registered or certified mail any statutory notice of deficiency is hereby delegated to the following officials:

(a) Chiefs, Appellate Branch Offices,

(b) Associate Chiefs, Appellate Branch Offices,

(c) Assistant Chiefs, Appellate Branch Offices,

(d) Director of International Operations,

(e) Assistant District Directors, and

(f) Chiefs of District Audit Divisions.

2. This authority may be redelegated only by District Directors and the Director of International Operations, who may redelegate to the Chief of Review Staff (or to the Chief of Technical Branch where that position has been established); Chief of Conference Staff; to Revenue Agents (Reviewers or Conferees) not lower than GS–11 for field audit cases; and to Revenue Agents (Reviewers or Conferees) and Tax Technicians (Reviewers or Conferees) not lower than GS–9 for office audit cases.

3. This Order supersedes Delegation Order No. 77 (Rev. 2) issued February 28, 1968 [C.B. 1968–1, 740].

RANDOLPH W. THROWER,
Commissioner.

(Filed by the Office of the Federal Register on October 22, 1969; 8:49 a.m., and published in the issue of the Federal Register for October 23, 1969, 34 F.R. 17202)

Delegation Order No. 93 (Rev. 2) (Effective October 20, 1969)

Authority to consent to a redetermination of aggregations by a taxpayer in the case of invalid basic aggregations or invalid additions

1. The authority vested in the Commissioner of Internal Revenue as prescribed in 26 CFR 1.614–2(d)(5) and 26 CFR 1.614–3(f)(8) is hereby delegated to Assistant Regional Commissioners (Appellate), Chiefs, Appellate Branch Offices, Associate Chiefs, Appellate Branch Offices, Assistant Chiefs, Appellate Branch Offices, District Directors, and Chiefs, District Audit Divisions to:

Consent to the reforming of aggregations by a taxpayer where the taxpayer has formed invalid basic aggregations or made invalid additions to valid or invalid basic aggregations, and

Consent, in the case of oil and gas wells where an invalid aggregation has been formed under section 614(b), to the treatment by a taxpayer of all the properties included in the aggregation, which fall within a single operating unit, under the provisions of section 614(d) rather than section 614(b) of the 1954 Code if so requested by the taxpayer.

2. In the case of oil and gas wells this delegation order shall apply only to taxable years subject to the 1954 Code beginning before January 1, 1964.

3. The authority delegated herein may not be redelegated.

4. This Order supersedes Delegation Order No. 93 (Rev. 1), issued August 8, 1967 [C.B. 1967–2, 599].

RANDOLPH W. THROWER,
Commissioner.

(Filed by the Office of the Federal Register on October 22, 1969; 8:49 a.m., and published in the issue of the Federal Register for October 23, 1969, 34 F.R. 17202)

Delegation Order No. 97 (Rev. 5) (Effective June 25, 1969)

Closing agreements concerning Internal Revenue tax liability

Pursuant to authority granted to the Commissioner of Internal Revenue by 26 CFR 301.7121–1(a); Treasury Department Order No. 150–32; dated November 18, 1953; and Treasury Department Order No. 150–36, dated August 17, 1954 [C.B. 1954–2, 733]:

1. The Assistant Commissioner (Compliance) is hereby authorized to enter into and approve a written agreement with any person relating to the internal revenue tax liability for alcohol, tobacco and firearms taxes, other than the manufacturers excise tax on firearms arising from application of sections 4181 and 4182 of the Internal Revenue Code, of such person (or of the person or estate for whom he acts) in respect of any prospective transactions or completed transactions affecting returns to be filed.

2. The Assistant Commissioner (Technical) is hereby authorized to enter into and approve a written agreement with any person relating to the internal revenue tax liability, other than for those taxes covered by delegation to the Assistant Commissioner (Compliance) in paragraph 1, of such person (or of the person or estate for whom he acts) in respect of any prospective transactions or completed transactions affecting returns to be filed.

3. The Assistant Commissioner (Compliance) is hereby authorized to enter into and approve a written agreement with any person relating to the internal revenue tax liability of such person (or of the person or estate for whom he acts) for a taxable period or periods ended prior to the date of agreement and related specific items affecting other taxable periods.

4. Regional Commissioners, Assistant Regional Commissioners (Appellate), Chiefs, and Associate Chiefs, Appellate Branch Offices, are hereby authorized in cases under their jurisdiction and in cases in which a closing agreement has been recommended for approval by the office of a District Director (but excluding cases docketed before the Tax Court of the United States) to enter into and approve a written agreement with any person relating to the internal revenue tax liability of such person (or of the person or estate for whom he acts) for a taxable period or periods ended prior to the date of agreement and related specific items affecting other taxable periods.

5. Regional Commissioners, Assistant Regional Commissioners (Appellate), Chiefs, and Associate Chiefs, Appellate Branch Offices, are hereby authorized in cases under their jurisdiction docketed in the Tax Court of the United States to enter into and approve a written agreement with any person relating to the internal revenue tax liability of such person (or of the person or estate for whom he acts) but only

in respect to related specific items affecting other taxable periods.

6. The Director of International Operations is hereby authorized to enter into and approve written agreements with any person relating to the internal revenue tax liability of such person (or of the person or estate for whom he acts) for a taxable period or periods ended prior to the date of agreement and related specific items affecting other taxable periods, as the competent authority in the administration of the operating provisions of the tax conventions of the United States. He is also authorized to enter into and approve a written agreement with any person relating to the internal revenue tax liability of such person (or of the person or estate for whom he acts) to provide for the mitigation of economic double taxation under section 3 of Revenue Procedure 64–54, C.B. 1964–2, 1008, and under Revenue Procedure 69–13, C.B. 1969–1, 402, and to enter into and approve a written agreement providing for such mitigation *and* relief under Revenue Procedure 65–17, C.B. 1965–1, 833.

7. District Directors of Internal Revenue are hereby authorized in cases under their jurisdiction to enter into and approve a written agreement with any person to provide that the internal revenue tax liability of such person (or of the person or estate for whom he acts) with respect to the taxability of earnings from a deposit or account of the type described in Revenue Procedure 64–24, C.B. 1964–1 (Part 1), 693, opened prior to November 15, 1962, will be determined on the basis that earnings on such deposits or accounts are not includible in gross income until maturity or termination, whichever occurs earlier, and that the full amount of earnings on the deposit or account will constitute gross income in the year the plan matures, is assigned, or is terminated, whichever occurs first.

8. The authority delegated herein does not include the authority to set aside any closing agreement.

9. Authority delegated in this Order may not be redelegated.

10. Delegation Order No. 97 (Rev. 4), issued March 13, 1967. [C.B. 1967–1, 528], is hereby superseded.

Effective June 25, 1969.

RANDOLPH W. THROWER,
Commissioner.

(Filed by the Office of the Federal Register on July 3, 1969; 8:46 a.m., and published in the issue of the Federal Register for July 4, 1969, 34 F.R. 11274)

Delegation Order No. 97 (Rev. 6) (Effective October 20, 1969)

Closing agreements concerning Internal Revenue tax liability

Pursuant to authority granted to the Commissioner of Internal Revenue by 26 CFR 301.7121–1(a); Treasury Department Order No. 150–32; dated November 18, 1953; and Treasury Department Order No. 150–36, dated August 17, 1954 [C.B. 1954–2, 733]:

1. The Assistant Commissioner (Compliance) is hereby authorized to enter into and approve a written agreement with any person relating to the internal revenue tax liability for alcohol, tobacco and firearms taxes, other than the manufacturers excise tax on firearms arising from application of sections 4181 and 4182 of the Internal Revenue Code, of such person (or of the person or estate for whom he acts) in respect of any prospective transactions or completed transactions affecting returns to be filed.

2. The Assistant Commissioner (Technical) is hereby authorized to enter into and approve a written agreement with any person relating to the internal revenue tax liability, other than for those taxes covered by delegation to the Assistant Commissioner (Compliance) in paragraph 1, of such person (or of the person or estate for whom he acts) in respect of any prospective transactions or completed transactions affecting returns to be filed.

3. The Assistant Commissioner (Compliance) is hereby authorized to enter into and approve a written agreement with any person relating to the internal revenue tax liability of such person (or of the person or estate for whom he acts) for a taxable period or periods ended prior to the date of agreement and related specific items affecting other taxable periods.

4. Regional Commissioners, Assistant Regional Commissioners (Appellate), Chiefs, Associate Chiefs, and Assistant Chiefs, Appellate Branch Offices, are hereby authorized in cases under their jurisdiction and in cases in which a closing agreement has been recommended for approval by the office of a District Director (but excluding cases docketed before the Tax Court of the United States) to enter into and approve a written agreement with any person relating to the internal revenue tax liability of such person (or of the person or estate for whom he acts) for a taxable period or periods ended prior to the date of agreement and related specific items affecting other taxable periods.

5. Regional Commissioners, Assistant Regional Commissioners (Appellate), Chiefs, Associate Chiefs, and Assistant Chiefs, Appellate Branch Offices, are hereby authorized in cases under their jurisdiction docketed in the Tax Court of the United States to enter into and approve a written agreement with any person relating to the internal revenue tax liability of such person (or of the person or estate for whom he acts) but only in respect to related specific items affecting other taxable periods.

6. The Director of International Operations is hereby authorized to enter into and approve written agreements with any person relating to the internal revenue tax liability of such person (or of the person or estate for whom he acts) for a taxable period or periods ended prior to the date of agreement and related specific items affecting other taxable periods, as the competent authority in the administration of the operating provisions of the tax conventions of the United States. He is also authorized to enter into and approve a written agreement with any person relating to the internal revenue tax lia-

bility of such person (or of the person or estate for whom he acts) to provide for the mitigation of economic double taxation under section 3 of Revenue Procedure 64–54, C.B. 1964–2, 1008, and under Revenue Procedure 69–13, C.B. 1969–1, 402, and to enter into and approve a written agreement providing for such mitigation *and* relief under Revenue Procedure 65–17, C.B. 1965–1, 833.

7. District Directors of Internal Revenue are hereby authorized in cases under their jurisdiction to enter into and approve a written agreement with any person to provide that the internal revenue tax liability of such person (or of the person or estate for whom he acts) with respect to the taxability of earnings from a deposit or account of the type described in Revenue Procedure 64–24, C.B. 1964–1 (Part 1), 693, opened prior to November 15, 1962, will be determined on the basis that earnings on such deposits or accounts are not includible in gross income until maturity or termination, whichever occurs earlier, and that the full amount of earnings on the deposit or account will constitute gross income in the year the plan matures, is assigned, or is terminated, whichever occurs first.

8. The authority delegated herein does not include the authority to set aside any closing agreement.

9. Authority delegated in this Order may not be redelegated.

10. Delegation Order No. 97 (Rev. 5), issued June 25, 1969 [page 284 this Bulletin], is hereby superseded.

RANDOLPH W. THROWER,
Commissioner.

(Filed by the Office of the Federal Register on October 22, 1969; 8:49 a.m., and published in the issue of the Federal Register for October 23, 1969, 34 F.R. 17202)

Delegation Order No. 107 (Rev. 1) (Effective October 20, 1969)

Authority to determine that certain "Savings Institutions" do not intend to avoid taxes by paying dividends or interest for period representing more than 12 months

1. The authority granted to the Commissioner of Internal Revenue under 26 CFR 1.461–1(e)(3)(ii) to determine that an organization referred to therein does not intend to avoid taxes (and therefore be permitted to deduct one-tenth of the amount of dividends or interest not allowed as a deduction for a taxable year under 26 CFR 1.461–1(e)(1) in each of ten succeeding taxable years) is hereby delegated to the following officials:

(a) Assistant Regional Commissioners (Appellate),

(b) District Directors,

(c) Director of International Operations,

(d) Chiefs, Appellate Branch Offices,

(e) Associate Chiefs, Appellate Branch Offices,

(f) Assistant Chiefs, Appellate Branch Offices,

(g) Assistant District Directors, and

(h) Chiefs of District Audit Divisions.

2. This authority may be redelegated only by District Directors and the Director of International Operations, who may redelegate to the Chief of Review Staff (or to the Chief of Technical Branch where that position has been established) and Chief of Conference Staff.

3. This Order supersedes Delegation Order No. 107 issued August 15, 1968 [C.B. 1968–2, 905].

RANDOLPH W. THROWER,
Commissioner.

(Filed by the Office of the Federal Register on October 22, 1969; 8:50 a.m., and published in the issue of the Federal Register for October 23, 1969, 34 F.R. 17203)

Delegation Order No. 109 (Rev. 1) (Effective October 20, 1969)

Authority to sign agreements determining inapplicability of exclusion under Section 963 of Internal Revenue Code of 1954

1. The authority granted to the Commissioner of Internal Revenue and to District Directors by 26 CFR 301.7701–9 and 26 CFR 1.963–6(c) to sign agreements determining that the exclusion under Section 963 of the Internal Revenue Code of 1954 does not apply to United States shareholders for certain taxable periods due to their failure to receive minimum distributions is hereby delegated to the following officials:

(a) Assistant Regional Commissioners (Appellate),

(b) District Director,

(c) Director of International Operations,

(d) Chiefs, Appellate Branch Offices,

(e) Associate Chiefs, Appellate Branch Offices,

(f) Assistant Chiefs, Appellate Branch Offices,

(g) Assistant District Directors,

(h) Assistant Director of International Operations,

(i) Chiefs of District Audit Divisions, and

(j) Chief of Audit Division, Office of International Operations.

2. This authority may be redelegated only by District Directors and the Director of International Operations, who may redelegate to the Chief of Review Staff (or to the Chief of Technical Branch where that position has been established) and Chief of Conference Staff.

3. This Order supersedes Delegation Order No. 109 issued February 11, 1969 [C.B. 1969–1, 380].

RANDOLPH W. THROWER,
Commissioner.

(Filed by the Office of the Federal Register on October 22, 1969; 8:50 a.m., and published in the issue of the Federal Register for October 23, 1969, 34 F.R. 17203)

Announcement of the Disbarment and Suspension of Attorneys, Certified Public Accountants and Enrolled Agents From Practice Before the Internal Revenue Service

Under Section 1026, Title 31 of the United States Code (1964 ed., Supplement II), 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 person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants or enrolled agents to practice before the Internal Revenue Service.

Attorneys, certified public accountants and enrolled agents 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.

To enable attorneys, certified public accountants and enrolled agents to identify such disbarred or suspended persons, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of persons who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date of disbarment or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant or enrolled agent so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and hearing before the Hearing Examiner, the following person was disbarred from further practice before the Internal Revenue Service.

Name	Address	Designation	Date of disbarment
Bertram G. Dienelt, Jr.	Washington, D.C.	Certified Public Accountant.	July 10, 1969

After due notice and hearing before the Hearing Examiner, the following person was suspended from further practice before the Internal Revenue Service.

Name	Address	Designation	Date of suspension
Samuel Lerner...	New York, N.Y.	Certified Public Accountant.	Thirty (30) months from November 1, 1969.

26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations. (Also Part III–A, Sections 5053, 5055, 5062, 5214, 5362; 245.170, 252.21, 252.23, 240.670.)

Finland has been added to the list of foreign countries to which reciprocal privileges involving the withdrawal of alcohol, distilled spirits, wine, and beer free of tax or with benefit of drawback for use on aircraft may be extended; Revenue Procedure 68–25 superseded.

Rev. Proc. 69–15

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to announce the addition of Finland to the list of foreign countries to which the reciprocal privileges provided by section 309 of the Tariff Act of 1930, 19 U.S.C. 1309, as amended, may be extended.

SEC. 2. BACKGROUND.

Under the provisions of section 309 of the Tariff Act of 1930, as amended, and sections 5053, 5055, 5062(b), 5214(a)(7), and 5362(c)(3) of the Internal Revenue Code of 1954, and applicable regulations of the Internal Revenue Service, alcohol, distilled spirits, beer, and wine may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft registered in foreign countries and actually engaged in foreign trade or trade between the United States and its possessions, or between Hawaii and any other part of the United States, or between Alaska and any other part of the United States where trade by foreign aircraft is permitted. Such privilege is extended in respect of aircraft registered in a foreign country only if the Secretary of Commerce has found that such foreign country allows, or will allow, substantially reciprocal privileges in respect of aircraft registered in the United States.

SEC. 3. FINLAND.

In addition to those countries listed in Revenue Procedure 68–25, C.B. 1968–2, 909, the Secretary of Commerce has found and has advised the Secretary of the Treasury that the country of Finland extends to aircraft registered in the United States and engaged in foreign trade privileges substantially reciprocal to those given aircraft registered in Finland and engaged in foreign trade. Corresponding privileges are, therefore, extended to aircraft registered in Finland and engaged in foreign trade.

SEC. 4. COMPLETE LIST OF FOREIGN COUNTRIES

The complete list of foreign countries to which reciprocal privileges may be extended is as follows:

Argentina	Greece
Australia	India
Bahama Islands	Israel
Belgium	Italy
Bermuda	Japan
Brazil	Lebanon
Canada	Mexico
Chile	Netherlands
Costa Rica	Nicaragua
Denmark	Norway
Dominican Republic	Pakistan
	Panama
Ecuador	Peru
Eire	Portugal*
El Salvador	Spain
Finland	Sweden
France	Switzerland
Germany, Federal Republic of	Trinidad and Tobago

*Except for ground equipment.

Union of Soviet Socialist Republics	United Kingdom
	Venezuela

SEC. 5. EFFECT ON OTHER DOCUMENTS.

This Revenue Procedure supersedes Revenue Procedure 68–25, C.B. 1968–2, 909.

SEC. 6. INQUIRIES.

Any inquiries concerning this Revenue Procedure should refer to its number and be addressed to the appropriate Assistant Regional Commissioner, Alcohol, Tobacco and Firearms.

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26 CFR 601.602: Forms and instructions.
(Also Part I, Sections 6011, 6041, 6042, 6051; 31.6011(a)–7, 1.6041–1, 1.6041–5, 1.6042–2, 31.6051–1.)

Magnetic tape records for Form 1099, U.S. Information Return; Form W–2, Wage and Tax Statement; or Form 1087, Nominee's Information Return, may be filed in lieu of the official form, subject, however, to prescribed conditions; Revenue Procedures 68–38, 68–39, 68–42, supplemented and Revenue Procedure 67–31 superseded.

Rev. Proc. 69–16

SECTION 1. PURPOSE

.01 The purpose of this Revenue Procedure is to state requirements and conditions under which information reportable on the following returns:

(a) Form 1099, U.S. Information Return;

(b) Form 1087, Nominee's Information Return;

(c) Form W–2, Wage and Tax Statement;

(hereafter referred to collectively as information returns), may be submitted to the Service by payers, employers, or nominees (hereafter referred to collectively as payers), in the form of magnetic tape in lieu of original copies of paper documents.

.02 This procedure replaces Revenue Procedure 67–31 dated July 24, 1967. The changes embodied herein are intended to clarify and simplify the requirements for magnetic tape reporting and to improve Service processing. The principal change is to eliminate the requirement for payers filing magnetic tape reports to submit renewal applications annually (see Section 2.06). *The tape specifications contained herein are unchanged from those in Revenue Procedure 67–31 except that even parity is the desired compatible tape characteristic. Odd parity is acceptable as a convertible characteristic, i.e. IRS will have odd parity tapes translated for them. However, if the Payer/Transmitter can provide either even or odd parity tapes, the Service prefers that even parity tapes be submitted. Otherwise, any magnetic tapes which fully met the requirements of Revenue Procedure 67–31 will be accepted in calendar year 1970.* (See Attachment 1, sec. 1.03.)

SEC. 2. APPLICATION FOR TAPE REPORTING.

.01 Information returns may be filed in the form of magnetic tape in lieu of paper documents. Such returns may be filed by payers, or by agents acting for a single payer or a group of payers. Tape reporting is not restricted to payers with the ability to submit all of their information on magnetic tape. A combination of tape records and paper documents are acceptable as long as there is no duplication or omission of documents.

.02 Payers or agents who desire to file information returns in the form of magnetic tape must first file a letter of application. This letter should be addressed to the Director of Internal Revenue Service Center in the region in which the payer or agent normally files returns, marked "Attention, Chief of Program Analysis Staff." Addresses of the Internal Revenue Service Centers are shown in section 8 of this Procedure.

The letter of request must contain the following:

(a) Name, address, and EI number of person, organization, or firm making the request.

(b) Name, title, and telephone number of person to contact regarding the request.

(c) An estimate, by type of form, of the number of returns to be reported in tape format, and the number, by type of form, to be reported on paper forms.

(d) Type and nature of equipment to be used to prepare tape files, i.e., manufacturer and model of main frame and tape drives, tape width (½", ¾", etc.), density (characters per inch), and recording code (BCD, Excess 3, Octal, etc.).

(e) Internal Revenue office where paper forms were filed last year.

(f) List of payers to be included in the file if the requester is an agent.

(g) Signature of official responsible for the preparation of tax reports or his authorized agent.

.03 The Service will act on applications and notify applicants of authorization or disapproval within 30 days of receipt of applications.

.04 Generally, payers using equipment compatible with the Service's can presume that tape reporting will be approved. Compatible tape characteristics are shown in attachment 1, section 1.01. If payers or agents have the capability to prepare several types of tapes, the Service prefers that compatible tapes be prepared.

.05 If payers or agents propose to submit convertible tapes, the Service will attempt to find conversion facilities. Generally, magnetic tape reporting will be disapproved only when the Service is unable to obtain facilities to convert a payer's file to a compatible form.

.06 In general, once authorization to file magnetic tape has been granted to a payer, such approval will continue in effect in succeeding years, provideing that the requirements of this Revenue Procedure are met, and there are no equipment changes by the payer. However, new applications are required if users change from compatible tapes to equipment producing convertible tapes, or tapes not listed as either compatible or convertible, or if they discontinue tape reporting for one or more years, then decide to resume this method of reporting.

SEC. 3. FILING OF TAPE RETURNS

.01 Packaging, shipping, and mailing instructions will be provided in the authorizing letter issued by the Service in response to an application for tape reporting.

.02 Payers submitting a portion of their information returns on magnetic tape and the remainder on paper forms, should file magnetic tape records and paper documents at the same location, but in separate shipments.

.03 A single Form 1096 or W–3 will be required from each payer to cover the entire shipment of returns, including those on paper and magnetic tape. For agents filing returns for several payers, the appropriate transmittal documents, Forms 1096 or W–3, must be filed for each payer whose payments are included in the transmittal. The required Forms 1096 or W–3 should be filed separately from the shipment of magnetic tape. If only a portion of the information returns (W–2, 1087, or 1099) are submitted on magnetic tape, the paper documents should be submitted with the Form 1096 or W–3, along with a statement that remaining returns are to be submitted in the form of magnetic tape. Note on the address of the magnetic tape shipments, "DELIVER UNOPENED TO THE TAPE LIBRARY".

.04 The dates prescribed for filing paper documents with the Service will also apply to magnetic tape filing. Requests for extensions of time for filing and related matters, should be made to the Service Center which has issued the authorizing letter, marked "ATTENTION: CHIEF, PROGRAM ANALYSIS STAFF". If an extension is granted by the Service, a copy of the letter granting the extension should be attached to the Form 1096 or W–3.

.05 The magnetic tape specifications contained in attachment 1 to this Revenue Procedure, must be adhered to unless deviations have been specifically granted by the Service.

.06 Service programs are flexible and may therefore be able to accommodate some minor deviations. Hence, payers who can substantially conform to these specifications but require such minor deviations are encouraged to contact the Chief of the Program Analysis Staff at one of the Internal Revenue Service Centers (see sec. 8 below for addresses). However, under no circumstances may tapes deviating from the specifications in attachment 1 be submitted without prior approval of the Service.

SEC. 4. PROCESSING OF TAPE RETURNS

.01 The Service will copy the information from the tapes. Normally, the original tapes received by the Service will be returned to the payers or agents by August 31 of the year in which submitted.

.02 However, if the tapes submitted to the Service are unprocessable, and must be returned for correction prior to processing they will be returned within 6 months of receipt of acceptable tapes.

SEC. 5. CORRECTED RETURNS

.01 The appropriate paper form will normally be used if it is necessary to correct payee records in the magnetic tape files. Each Form W–2, 1099, or 1087 correcting a tape record must be annotated in the manner specified for corrected returns in Circular E, Revenue Procedure 68–39, or 68–42 as appropriate. Corrected documents should contain all relevant information so that they completely supersede the returns recorded on tape.

.02 Returns correcting paper documents should be bundled separately from other paper documents. When correcting documents are shipped separately, corrected Forms 1096 or W–3 must also be filed.

.03 If a large volume of corrected returns are necessary and the payer or agent possesses the capability to provide such corrections on tape, he should contact the Chief of the Program Analysis Staff at the Internal Revenue Service Center to which the tape returns were or are to be submitted.

SEC. 6. EFFECT ON PAPER DOCUMENTS

.01 Reports on magnetic tape can be substituted for only the original copy (copy A) of Forms W–2, 1099, and 1087. When magnetic tape returns are filed in lieu of Forms 1099 or 1087, payers will not be required to furnish payees or other persons with copies which conform to the format and paper specifications of Revenue Procedures 68–39 or 68–42 as appropriate. However, payers must supply their payees with the information required to be shown on the paper forms, in a manner conducive to proper reporting on their tax returns. In addition, payers filing magnetic tape returns in lieu of Form W–2, must continue to furnish their payees with the prescribed forms or with paper substitutes which meet the requirements and specifications in Revenue Procedure 68–38.

.02 If only a portion of the information returns is reported on magnetic tape and the remainder is reported on paper forms, those returns not submitted on magnetic tape must be filed on the appropriate prescribed forms, or on paper substitutes meeting the format requirements and paper specifications in Revenue Procedures 68–38, 68–39, or 68–42.

SEC. 7. DATA ENTRIES

.01 The Service expects that payers will make every effort to keep to a minimum information returns submitted without taxpayer identifying numbers, through continued compliance with the requirements set forth in section 1.6109 of the Income Tax Regulations, and section 31.6109 of the Employment Tax Regulations. However, when a taxpayer identification number of a payee has not been furnished to the payer, the specifications in attachment 1 permit its omission.

.02 The Service must be able to identify the surname associated with the taxpayer identifying number furnished on an information return. When returns are received in the form of paper documents this is accomplished through a manual editing process. However, manual editing is precluded when returns are received on magnetic tape. Hence, the attached specifications include a data field in the payee records called "Name Control", in which the first four alphabetic characters of the payee surname are to be entered by payers.

.03 If payers are unable to provide the first four characters of the payee surname, the specifications permit the submission of information returns on magnetic tape with the Name Control field left blank. However, compliance with the following will facilitate the Service computer programs required to generate the Name Control.

(a) Record the surname on the first name line.

(b) A blank space should precede the surname unless the surname begins in the first position of the field.

(c) In cases of multiple payees, provide the required linkage by recording an asterisk immediately preceding the surname of the person whose identifying number has been provided, or place the surname of the linked payee before all other names.

.04 Sometimes the payee identification recorded on the payer's records is lengthy, and exceeds the 80 characters allotted on the magnetic tape records. This is most common in the case of trusts or other types of fiduciary accounts; the first 80 characters of the payee identification normally provide sufficient descriptive data for Service purposes. Although it is preferred that payers would truncate or abbreviate lengthy payee descriptions, provision is made in the specifications for additional payee descriptions.

.05 Provision is also made in these specifications for data entries not required for Federal tax purposes but which may be required by State or Local governments, in order to minimize the programming burden should payers desire to report on tape to State or Local as well as to the Federal government.

SEC. 8. ADDITIONAL INFORMATION

Requests for additional copies of this Revenue Procedure and the attached specifications, or requests for additional information on tape reporting should be addressed to the Chief, Program Analysis Staff, Internal Revenue Service Center, at one of the following addresses:

(a) *Southeast Region*
P.O. Box 47-421, Doraville, Ga. 30340

(b) *Midwest Region*
P.O. Box 5321, Kansas City, Mo. 64131

(c) *Central Region*
P.O. Box 267, Covington, Ky. 41012

(d) *Southwest Region*
P.O. Box 934, Austin, Tex. 78767

(e) *North Atlantic Region*
P.O. Box 311, Andover, Mass. 01810

(f) *Mid-Atlantic Region*
11601 Roosevelt Boulevard, Philadelphia, Pa. 19155

(g) *Western Region*
P.O. Box 388, Ogden, Utah 84401

SEC. 9. EFFECT ON OTHER DOCUMENTS

This Revenue Procedure supplements Revenue Procedures 68-38, C.B. 1968-2, 927; 68-39, C.B. 1968-2, 932; and 68-42, C.B. 1968-2, 944; and supersedes Revenue Procedure 67-31, C.B. 1967-2, 644.

Attachment 1—Magnetic Tape Specifications

SECTION 1. GENERAL

.01 These specifications prescribe the required format and content of the records to be included in the file, but not the methods or equipment to be used in their preparation. Usually the Service will be able to process, without translation, any compatible tape file. To be compatible, a tape file must meet all of the following:

Type of tape.....	½ inch Mylar base, oxide coated.
Recording density.	556 or 800 CPI.
Parity	Even.
Interrecord gap...	¾ inch.
Recording code...	7 channel binary coded decimal (BCD).

.02 Convertible tapes for which conversion facilities are currently available are:

9 channel (EBCDIC).

9 channel (ASCII) see Bureau of Standards FIPS Publication 3—Federal Information Processing Standards Publication.

Odd parity.

200, 1600 densities.

The Service will attempt to find conversion facilities for any other characteristics listed on the Magnetic Tape Application form that differ from the above specifications.

03. *Any magnetic tapes which fully meet the requirements of Revenue Procedure 67-31 will also meet the requirements specified herein with the exception of odd parity. Only even parity is compatible, although odd parity is listed as a convertible tape characteristic.* An acceptable tape file will contain, for each payer, the following:

(1) A Payer/Transmitter Record ("A" Record);

(2) A series of Payee Records ("B" Records); and

(3) An End of Payer Records ("C" Record).

In addition, multiple reel files will have the following:

(4) End of Reel Records ("D" Record).

All files will contain the following:

(5) An End of Transmission Record ("F" Record).

All records including headers and trailers if used, must be written at the same density.

SEC. 2. CONVENTIONS AND DEFINITIONS

.01 Certain conventions may be required by the programming system or equipment used by the payer, with respect to header and trailer labels, record marks, and tape marks. Their use is optional, but if present they must adhere to the following:

Header Label.....	1. Can only be the first record on a reel. 2. Must consist of a maximum of 80 characters. 3. First 4 characters must be 1 HDR.
Trailer Label.....	1. Can only be the last record of a reel. 2. Must consist of a maximum of 80 characters.

Record Mark.....	1. Can only be at the end of a block or the end of a record.
Tape Mark.....	1. If trailer labels are not used they can only follow a D record, (end of reel) or an F record (end of transmission). 2. If header and trailer labels are used, it cannot follow a header label but must precede and follow a trailer label.

.02 DEFINITIONS

Element	*Description*
b.....	Denotes a blank position.
Special character.....	Any character that is not a numeral, a letter, or a blank.
Payer.....	Person or organization, including paying agent, making payments. The Payer will be held responsible for the completeness, accuracy, and timely submission of magnetic files.
Transmitter.....	Person or organization preparing tape files. May be Payer or agent of Payer.
Payee.....	Person(s) or organization(s) receiving payments from Payer.
Coding Range.....	Shows the lowest and highest codes acceptable. For example: Coding Range 0–4 indicates that codes 0, 1, 2, 3, or 4 are acceptable in the tape position.
Record.....	A group of related fields of information, treated as a unit.
Blocked records.....	2 or more records grouped together between interrecord gaps.
Unblocked records.....	A single record which is written between interrecord gaps.
Blocking Factor.....	Number of records grouped together to form a block. Should be "1" if records are not blocked (unblocked).
File.....	For the purposes of this procedure, a file consists of all tape records submitted by a Payer or transmitter for a specific type of information document. *For example:* Payers reporting data for both Form W–2 and Form 1099 would submit two files. One file would contain W–2 data, the other 1099 data. *Another example:* A Payer transmits data for Form W–2 from several locations (payroll office, data center, regional office, etc.), with data from each on separate reels. The submission from each location would be a file.
Reel.....	A spool of magnetic tape.
Record mark.....	Special character used either to limit the number of characters in a data transfer, or to separate blocked records on tape. For compatibility with the Service's equipment, use BCD bit configuration A82.

Element	*Description*
Tape mark.....	Special character that is written on tape to signify the physical end of the recording on tape. For compatibility with the Service's equipment, use BCD bit configuration 8421.
EIN.....	Employer Identification Number.
SSN.....	Social Security Number.

.03 Since the Service is not restricting magnetic tape reporting to payers or transmitters with specific types of equipment, or prescribing the methods used to prepare the tapes files, the Payer/Transmitter ("A" Record), End of Payer ("C" Record), End of Reel ("D" Record), and End of Transmission ("F" Record), perform the functions normally assigned to header and trailer labels, and related conventions. The Payer/Transmitter Record serves the purpose of a header label, the End of Payer Record indicates that all Payee Records for a Payer have been written, the End of Reel Record signals that no more Payee Records are written on the reel, and the End of Transmission Record indicates that the end of the file has been reached. In addition to the functions stated above, the End of Reel and End of Payer Records are used to balance each reel or each payer's records on a reel.

SEC. 3. RECORD LENGTH

.01 The tape records prescribed in the specifications may be blocked or unblocked, subject to the following:

1. A block may not exceed 4,000 tape positions.

2. If the use of blocked records would result in a short block at the end of the file representing all payments made by the payer, all remaining positions of the block must be filled with 9's. However, filling with 9's is allowable only in the last block of returns for a payer.

3. Two forms of blocking are acceptable:

(a) Only payee records are blocked; all other records are unblocked.

(b) All records, except header and trailer labels, if used, are blocked. If so, and if payments from more than one payer are reported on the same tape, a Payer/Transmitter Record cannot be in the middle of a block, but must be the first record in a block.

.02 Provision is made for special data entries in the payee record ("B" Record). These entries are optional; a payer or agent may choose not to utilize this field. If the field is utilized it must be present on all payee records of a payer. The field is intended to serve one or both of these purposes:

1. Carry information required by state or local governments in connection with income reporting on magnetic tape to those jurisdictions when authorized.

2. Carry additional payee description if the eighty characters provided in the payee record ("B" Record) are insufficient. However, it would be preferable to the Service if such lengthy payer records were truncated or otherwise shortened. (Contact the Service Center for detailed instructions if additional payee description will be required.)

SEC. 4. PAYER/TRANSMITTER ("A" RECORD)

Identifies the payer and transmitter of the tape files and provides parameters for the succeeding Payee records. The Service relies in its computer programs on the absolute relationship between the parameters in the Payer/Transmitter Record and the data fields to which they apply. The number of Payer/Transmitter Records appearing on one tape reel will depend on the number of payers being reported. A transmitter may include Payee Records ("B" Records) for more than one payer on a tape reel; however, each separate Payer's Payee Records must be preceded by a Payer/Transmitter Record ("A" Record). Separate tape files on separate reels must be submitted if payer is reporting payment data for more than one type of information return. When multiple reels are required for a single file, the correct Payer/Transmitter Record ("A" Record) must be repeated as the first record (second record if header labels are used) on every succeeding reel in the file to which it applies, and the reel number must be incremented by 1 on each tape after the first one.

Tape Position	Element Name	Entry
1.....	Record Type.....	Enter "A". Must be first character of each Payer/Transmitter Record.
2.....	Payment Year.....	The last digit of the year for which payments are being reported.
3–5.....	Reel Number.....	Serial Number assigned by the transmitter to each reel, starting with 001. If header labels are used, this should be the same as Reel Sequence Number.
6–14.....	EIN-Payer.....	Enter the 9 numeric characters of the Employer Identification Number. Do *NOT* include the hyphen.
15–16.....	Blocking Factor...	Enter the number of records in a block. A block must not exceed 4,000 positions.
17.....	Type of Information.	Enter "1" for 1099. Enter "2" for 1087.
	Document Reported in the Payee Records Following.	Enter "3" for W–2. Enter "4" for Agriculture Subsidy.

Tape Position	Element Name	Entry
18–24.....	Amount Indicator.	Amount Codes will be entered in Amount Indicator to show the type of payments appearing in the Payment Amount fields and the position of such payments. The Amount Indicator Codes will apply to all succeeding Payee Records in a file. Definition of each type of payment listed below is the same for magnetic tape as for equivalent paper documents. Up to 7 payment amounts may be included in a payee record: Enter Codes for the amount fields which will be present, beginning in tape position 18, in ascending sequence and leaving no blank spaces between indicators: Then fill remainder of the field with blanks: If a particular Amount Type will not be used, do not enter Amount Code in Amount Indicator: If an Amount Type will be used for some but not all records, enter the Amount Code in the Amount Indicator: Position 18 must always have a code other than blank: If position 17 of a Payer/Transmitter Record is 1 (for 1099's), coding range is 1–7, or b: If position 17 is 2 (for 1087's), coding range is 1–3 or b. If position 17 is 3 (for W–2's) coding range is 1–7 or b. Note: "b" (a blank) is the only code that may appear in 2 or more positions of the Amount Indicator, after the 1st position and it cannot be followed by an Amount Code: The payment codes are as follows: PAYMENTS NORMALLY REPORTED ON FORM 1099 *Amount Code* — *Amount Type* 1 Dividends and other distributions: 2 Earnings from savings and loan associations, mutual savings banks, credit unions, etc: 3 Interest. Do not include items reportable under Code 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 items reportable on Form W–2: *Example:* If position 17 of the payer/Transmitter Record is "1" (for 1099's) and positions 18–24 are "13bbbbb", this indicates only 2 amount fields are used: In this case, dividends and interest: PAYMENTS NORMALLY REPORTED ON FORM 1087 1 Dividends and other distributions: 2 Earning from savings and loan associations, mutual savings banks, credit unions, etc: 3 Interest: Do not include items reportable on Form 1099 under Code 4: Example: If position 17 of the Payer/Transmitter Record is "2" (for 1087's) and positions 18–24 are "1bbbbbb", this indicates only 1 amount field is used. It represents dividends and other distributions:

Tape Position	Element Name	Entry
		PAYMENTS NORMALLY REPORTED ON FORM W–2
		Amount Code — *Amount Type* 1 Federal income tax withheld (must be present). 2 Wages paid subject to withholding (must be present). 3 Salary or other compensation which was not subject to withholding. 4 FICA employee tax (must be present). 5 Total FICA wages paid. 6 Excludable Sick Pay. 7 Uncollected employee tax tips. Example: If position 17 of Payer/Transmitter Record is 3, codes "124bbbb", in positions 18–24 (for W–2's) indicate that there are only 3 amount fields in all the payee records. The 1st field represents Federal income tax withheld; the 2nd, wages paid subject to withholding; and 3rd, FICA employee tax.
25–27.....	"b" (Blank).....	Not used by the Service.
28–30.....	Record Length.... Payer/Transmitter Record.	Enter number of positions allowed for Payer/Transmitter Record. If record mark or equivalent is used, include in count.
31–33.....	Record Length.... Payee Record.	Enter number of positions allowed for a Payee Record. If Special Data field is present in payee record and/or if record marks are used, they must be included in the count.
34–40.....	Blank.....	Not used by the Service.
41–80.....	1st Name Line.... Payer.	Enter first name line of payer. Left justify and fill with blanks.
81–120.....	2nd Name Line... Payer.	Enter second name line of payer. Left justify and fill with blanks. Leave blank if not used.
121–160.....	Street Address..... Payer.	Enter street address of payer. Left justify and fill with blanks.
161–200.....	City, State, ZIP Code. Payer.	Enter City, State, and ZIP Code of payer. Left justify and fill with blanks.

The following items are required if the Payer and Transmitter are not the same, or the transmitter includes files for more than one payer:

Tape Position	Element Name	Entry
201–240.....	1st Name Line.... Transmitter.	Enter 1st name line of Transmitter. Left justify and fill with blanks.
241–280.....	2nd Name Line ... Transmitter.	Enter 2nd name line of Transmitter. Left justify and fill with blanks. Leave blank if not required.
281–320.....	Street Address..... Transmitter.	Enter street address of Transmitter. Left justify and fill with blanks.
321–360.....	City, State, ZIP Code— Transmitter.	Enter City, State, and ZIP Code of Transmitter. Left justify and fill with blanks.

Sec. 5. Payee Record ("B" Record)

Contains payment record from individual information returns. Records may be blocked or unblocked. A block may not exceed 4,000 tape positions. All records must be fixed length.

Tape Position	Element Name	Entry
1	Record Type	Enter "B". Must be 1st character of each Payee Record.
2–3	Payment Year	Last 2 digits of the year for which payments are being reported.
4–6	Blank	Not used by the Service.
7–10	Name Control	If the Type of Account in position 11 is a "1," enter "1111." Otherwise, enter the first 4 letters of the surname of the payee. A hyphen should be treated as a character but a blank between characters should be disregarded. In last names of less than 4 letters or hyphens, the remaining positions must be blank. If Name Control is not determinable by the payer, leave this field blank.
11	Type of Account	Enter a "1" if the payee is a business or organization entity, if the entry in positions 12–20 is an Employer Identification Number. Enter a "2" if the entry in positions 12–20 is a Social Security Number. Enter a "9" if the payee is a nonresident alien or a foreign corporation doing business solely outside the United States and is, therefore, not required to have an identification number. Enter a "b" if a Social Security Number is required but is not available.
12–20	SSN or EIN of Payee.	Enter Social Security Number or Employer Identification Number of payee, as appropriate. Enter blanks (do not fill with zeros) if number is not available. This field must be blank if position 11 is a "9" or "b".
21–30	Payer's Account	Enter Account Identification Number assigned to Payee by Payer. This item is optional, but its presence may facilitate subsequent reference to payer's files if questions arise regarding specific records in the file. Enter blanks if there is no Payer Account Identification Number.
	Payment Amounts.	Record each payment amount in dollars and cents, omitting dollar sign, commas, and periods. Right justify and fill unused positions with zeros. Payment amount fields identified by a code other than blank in the Amount Indicator (Positions 18–24 of the Payer/Transmitter Record), should be zero filled when amounts are not applicable to a particular record. Do not provide a payment amount field when the Amount Indicator is blank. *For example:* The Amount Indicator contains 123bbbb. Payee Records in this file should have only 3 payment amount fields. If Amount Indicator contains 12367bb, Payee Records should have 5 payment amount fields.
31–40	Payment Amount 1.	This amount is identified by the amount code in position 18 of the Payer/Transmitter Record. This entry must always be present.
41–50	Payment Amount 2.	This amount is identified by the amount code in position 19 of the Payer/Transmitter Record. If position 19 of the Payer/Transmitter Record is blank, do not provide for this payment field.

Tape Position	Element Name	Entry
51–60	Payment Amount 3.	This amount is identified by the amount code in position 20 of the Payer/Transmitter Record. If position 20 of the Payer/Transmitter Record is blank, do not provide for this payment field.
61–70	Payment Amount 4.	This amount is identified by the amount code in position 21 of the Payer/Transmitter Record. If position 21 of the Payer/Transmitter Record is blank, do not provide for this payment field.
71–80	Payment Amount 5.	This amount is identified by the amount code in position 22 of the Payer/Transmitter Record. If position 22 of the Payer/Transmitter Record is blank, do not provide for this payment field.
81–90	Payment Amount 6.	This amount is identified by the amount code in position 23 of the Payer/Transmitter Record. If position 23 of the Payer/Transmitter Record is blank, do not provide for this payment field.
91–100	Payment Amount 7.	This amount is identified by the amount code in position 24 of the Payer/Transmitter Record. If position 24 of the Payer/Transmitter Record is blank, do not provide for this payment field.
Next 40 positions after Last Payment Amount field, see footnote.[1]	1st Name Line Payee.	Enter the name of the payee. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required, utilize the 2nd Name Line field. However, in such cases, the surname of the individual whose Social Security Number has been provided in positions 12–20 MUST appear in the first name line.
Next 40 positions after the 1st Name Line.	2nd Name Line Payee.	If the payee name requires more space than is available in the 1st Name Line, enter the remaining portion of the name in this field. Left justify and fill unused positions with blanks. Fill with blanks if this field is not required. If more than 80 positions is required for payee name, contact the Service Center for instructions.
Next 40 positions after 2nd Name Line.	Street Address Payee.	Enter street address of payee. Left justify and fill with blanks. Enter blanks if not available.
Next 40 positions after Street Address.	City, State, ZIP Code.	Enter the City, State, and ZIP Code of the payee, in that sequence.
Next field after City, State, and ZIP Code (maximum at 100 positions).	Special Data Entries—Entries Optional.	The last portion of each Payee Record may be used to record information required for State or Local Government or for other purposes. Special Data Entries will begin in position 201, 211, 221, 231, 241, 251, or 261, depending on the number of payment amount fields included in the record.

[1] If only 1 amount field, 1st Name Line would start in position 41; if 3 amount fields it would start in position 61, etc.

SEC. 6. END OF PAYER RECORD ("C" RECORD)

Write this record after the last Payee Record ("B" Record) for a Payer has been written. A tape reel may contain more than one End of Payer Record if the last Payee Record for more than one Payer is written on the reel. Each End of Payer Record must contain a count of payees and totals of each payment amount reported for all Payee Records written on the same reel, which have not been summarized in preceding End of Payer Records on the reel. The End of Payer Record must be followed by a new "A" Payer/Transmitter Record, a "D" End of Reel Record, or "F" End of Transmission Record. The new Payer/Transmitter Record, however, cannot be written in the same block as the End of Payer Record. A new block, with the new Payer/Transmitter Record as the first record, must be started. The End of Payer Record cannot be followed by a Tape Mark.

Tape Position	Element Name	Entry
1	Record Type	Enter "C". Must be 1st character of each End of Payer Record.
2–7	Number of Payees	Enter the total number of payees covered by the payer on this tape reel. Zero fill if less than 6 positions are required.
8–19	Control Total 1	Enter grand total of each payment amount covered by the payer on this tape reel. Right justify and zero fill. If less than 7 amounts are being reported in the Payee Records, zero fill remaining Control Total positions. *For example:* If only 1 payment amount is being reported, zero fill tape positions for Control Totals 2, 3, 4, 5, 6, and 7.
20–31	Control Total 2	
32–43	Control Total 3	
44–55	Control Total 4	
56–67	Control Total 5	
68–79	Control Total 6	
80–91	Control Total 7	

SEC. 7. END OF REEL RECORD ("D" RECORD)

Write this record when the end of the normal writing area of each reel has been reached, but all records in the file have not been written. This record indicates that there are additional reels in the file. Each End of Reel Record must contain a count of payees and totals of each payment amount reported for all Payee Records not summarized in End of Payer Records which may precede it on the reel. The counts and totals in the End of Reel Record should summarize only the Payee Records which precede it on the reel. This record cannot be followed by an "A" Payer/Transmitter, "C" End of Payer, or "F" End of Transmission Record. A Tape Mark or Tape Mark and Trailer Label (see Attachment 1, sec. 2.01) may follow.

Tape Position	Element Name	Entry
1	Record Type	Enter "D". Must be 1st character of each End of Reel Record.
2–7	Number of Payees	Enter the total number of payees not summarized in the End of Payer Records on this tape reel. Zero fill if less than 6 positions are required.
8–19	Control Total 1	Enter grand total of each payment amount not summarized in End of Payer Records on this tape reel. Right justify and zero fill. If less than 7 amounts are being reported on the Payee Records, zero fill remaining Control Total positions. For example: If only 1 payment amount is being reported, zero fill tape positions for Control Totals 2, 3, 4, 5, 6, and 7.
20–31	Control Total 2	
32–43	Control Total 3	
44–55	Control Total 4	
56–67	Control Total 5	
68–79	Control Total 6	
80–91	Control Total 7	

SEC. 8. END OF TRANSMISSION ("F" RECORD)

White this record after the last End of Payer Record in the file. This record can be followed only by a Tape Mark or Tape Mark and Trailer Label (see ATTACHMENT 1, sec. 2.01)

Tape Position	Element Name	Entry
1	Record Type	Enter "F". Must be 1st character of the End of Transmission Record.
2–4	Number of Payers	Enter total number of payers on this file. Zero fill. Right justify.
5–7	Number of Reels	Enter total number of reels in this file. Zero fill. Right justify.
8–30	Zeros	Zero fill.

SEC. 9. TAPE LAYOUTS

The following charts shows, by type of file, the record types to be used in the first two and the last three records written on a tape reel.

Type of File	1st record type	2nd record type	2nd from last record type	Next to last record type	Last record type
Single payer, single reel	A	B	B	C[1]	F
Single payer, multiple reels:					
Reel 1	A	B	B	B	D[2]
Last reel	A	B	B	C[1]	F
Multiple payers, single reel:					
Payer 1	A	B	B	B	C
Payer 2	A	B	B	B	C
Last payer	A	B	B	C[1]	F

See footnotes at end of table.

Type of File	1st record type	2nd record type	2nd from last record type	Next to last record type	Last record type
Multiple payers, multiple reels; first payer's records split between reel 1 and reel 2; second payer's records split between reel 2 and reel 3:					
Reel 1: Payer 1	A	B	B	B	D[2]
Reel 2:					
Payer 1	A	B	B	B	C
Payer 2	A	B	B	B	D[1]
Reel 3:					
Payer 2	A	B	B	B	C
Payer 3	A		B	C[1]	D[3]
Reel 4: Last payer		B	B	C[1]	F
Multiple payers, single transmitter, separate files for each payer:					
File 1: Payer 1: Last reel	A	B	B	C[1]	F
File 2: Payer 2:					
Reel 1	A	B	B	B	D[2]
Last reel	A	B	B	C[1]	F
File 3: Payer 3: Last reel	A	B	B	C[1]	F
Single payer, multiple transmitter (payer submits files from various locations):					
Payer 1:					
Location 1: Last reel	A	B	B	C[1]	F
Location 2: Last reel	A	B	B	C[1]	F
Single payer, multiple transmitter, etc.:					
Location 3:					
Reel 1	A	B	B	B	D[2]
Reel 2	A	B	B	B	D[2]
Last reel	A	B	B	C[1]	F

[1] Must contain "Number of Payees" and "Control Totals" summarizing all Payee Records written for this Payer on this reel.
[2] Must contain "Number of Payees" and "Control Totals" summarizing all Payee Records written on this reel.
[3] "Number of Payees" and all "Control Totals" fields must be zero filled.

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26 CFR 601.602: Forms and instructions. (Also Part I, Sections 6001, 6011, 6018, 6019: 1.6001–1, 1.6011–1, 20.6018–1, 25.6019–1.)

Conditions are prescribed for the reproduction of certain Federal tax return forms and schedules which may be used for filing purposes; Revenue Procedure 68–36 superseded.

Rev. Proc. 69–17

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to restate the requirements of the Internal Revenue Service relating to the preparation of acceptable reproductions of Federal tax return forms and schedules for filing purposes in lieu of the official forms and schedules.

SEC. 2. SPECIFICATIONS.

.01 Subject to the conditions enumerated in section 3 below, the Service will accept, for filing purposes, reproduced copies of any of the following tax return forms and schedules:

U.S. Estate Tax Return, Form 706.

U.S. Gift Tax Return, Form 709.

Claim, Form 843.

U.S. Exempt Cooperative Association Income Tax Return, Form 990–C.

U.S. Return of Employees' Trust Described in Section 401(a) and Exempt Under Section 501(a) of the Internal Revenue Code of 1954, Form 990–P.

U.S. Individual Income Tax Return, Form 1040.

Itemized Deductions, Schedule A (Form 1040).

Dividend and Interest Income, Schedule B (Form 1040).

Profit (or Loss) From Business or Profession, Schedule C (Form 1040).

Sales or Exchanges of Property, Schedule D (Form 1040).

Supplemental Income, Schedule E (Form 1040).

Farm Income and Expenses, Schedule F (Form 1040).

Income Averaging, Schedule G (Form 1040).

Retirement Income Credit, Schedule R (Form 1040).

Computation of Social Security Self-employment Tax, Schedule SE (Form 1040).

Tax Computation, Schedule T (Form 1040).

U.S. Departing Alien Income Tax Return, Form 1040C.

U.S. Fiduciary Income Tax Return, Form 1041.

Gains and Losses From Sales or Exchanges of Property, Schedule D (Form 1041).

Beneficiary's Share of Income, Deductions, and Credits, Schedule E (Form 1041).

Allocation of Accumulation Distribution, Schedule J (Form 1041).

U.S. Partnership Return of Income, Form 1065.

Gains and Losses From Sales or Exchanges of Property, Schedule D (Form 1065).

Statement in Support of Credit Claimed by Domestic Corporation for Taxes Paid or Accrued to a Foreign Country or a Possession of the United States, Form 1118.

U.S. Corporation Income Tax Return, Form 1120.

Schedule of Gains and Losses From Sales or Exchanges of Property, Schedule D (Form 1120).

U.S. Small Business Corporation Return of Income, Form 1120–S.

Gains and Losses From Sales or Exchanges of Property, Schedule D (Form 1120–S).

Return of Information and Authorization and Consent of Subsidiary Corporation Included in a United States Consolidated Income Tax Return, Form 1122.

Statement for the Purpose of Extending Time for Payment of Taxes by Corporations Expecting Carrybacks, Form 1138.

Application for Tentative Carry-ack Adjustment, Form 1139.

.02 Specifications.—Basic specifica-ions such as margin, pagination, etc., vill be printed in the margins of the eproduction proofs and must be re-noved before printing. These margins nust be maintained on reproductions.

EC. 3. CONDITIONS.

.01 Reproductions must be facsimi-es of the official form produced by hoto-offset, photoengraving, photo-opying, or other similiar reproduction rocess.

.02 Reproductions must be on hemical wood writing paper equal r better than the quality used for the fficial forms. The thickness of the tock cannot be less than 0.0030 inch.

.03 Reproductions must substan-ially duplicate the colors of the paper nd ink of the official form in order o be accepted, except, that Form 1040 eproductions may be in black ink.

.04 Reproductions must have a igh standard of legibility, both as to riginal form and as to filled-in matter. The Service reserves the right to re-ect any reproductions with poor legi-ility, to withdraw the benefits of this evenue Procedure from any firm or ndividual, and to reject any process vhich fails to meet these standards.

.05 Reproductions can be the same ize as that of the official form. How-ver, the standard commercial size of ½ x 11 (as noted in columns 2 and of table in section 6 below) will be ccepted. The image size of printed aterial should be as close as possible o that of the official form.

.06 Reproductions of each schedule nust be on a separate page and must e attached to the form in the sequence rescribed in the instructions. The ervice will not object if the reproduc-on has a different fold than that pro-ided on the official form.

.07 Reproductions of official forms and nonstandard forms which do not meet the requirements of this Revenue Procedure may not be filed in lieu of the official forms. They may, however, be filed as supporting statements to provide detail and explain entries made on the official forms.

SEC. 4. ADDITIONAL INSTRUCTIONS.

.01 The Service ordinarily does not undertake to approve or disapprove the specific equipment or process used in reproducing official forms, but requires only that the reproduced forms and schedules satisfy the stated conditions.

.02 Reproductions of forms may be made after insertion of the tax computations and other required information. However, all signatures on forms to be filed with the Internal Revenue Service must be original signatures, affixed subsequent to the reproduction process.

.03 Reproductions of forms and schedules meeting the above conditions may be used without the prior approval of the Service. However, if specific approval of a reproduction of any such form or schedule is desired, or if the use of a reproduction of any form or schedule not listed herein or otherwise specifically authorized is desired, a sample of the proposed reproduction should be forwarded, by letter to the Commissioner of Internal Revenue, Attention: D:S:E, 1111 Constitution Avenue, NW., Washington, D.C. 20224, for consideration.

SEC. 5. SPECIAL INSTRUCTIONS FOR FORMS 1040.

.01 Forms 1040 and related schedules may be machine generated provided all the conditions set forth above are met when filing such returns. Although the entries may be generated by machine the exact format of Form 1040 must be reproduced, except for color (see section 3.03).

.02 Standard stock paper of the same size and quality as the official forms may be substituted for Schedules A, B, C, D, E, F, G, R, SE, and T. The format of each substitute schedule must follow the format of the official schedule insofar as item captions, line references, etc., are concerned, even though data may not be required to be reported for one or more of the items listed. Descriptive captions may be limited to one print line by resorting to abbreviations, contractions, and omission of articles, prepositions, etc., if sufficient key words are retained to permit ready identification of the item. Each substitute schedule must begin on a separate sheet.

.03 Attachments may be used to supply explanatory details to support entries on the related official schedules. These explanatory attachments are acceptable only as supporting documents to the official schedule—they are not acceptable for filing as substitutes for the official form. The supporting statements must furnish all required information in the same sequence as called for on the official forms and be attached to the schedule in the same order as the entries appear on the official forms. Supporting statements must conform to the size of the schedule to which they apply. The totals on these supporting statements must also be entered on the appropriate official forms.

.04 An internal control number if desired may be printed on the top of the form if it is printed to the left of the center of the form. It may not appear in the upper right corner of the form.

SEC. 6. PHYSICAL ASPECTS.

The conditions with respect to size, number of printed pages, quality of paper, and color of both paper and ink are as follows:

Form No.	Official IRS trim size [1] (inches)	Tolerances permitted in size [2]	Number of printed pages	Color of—	
				Paper	Ink
(1)	(2)	(3)	(4)	(5)	(6)
706	8⅜ x 11	8½ x 11	40	White	Black.
709	8½ x 11		2	Buff	Do.
843	8 x 10½	8½ x 11	2	White	Do.
990–C	8 x 11	8½ x 11	4	...do	Do.
990–P	8½ x 11		4	...do	Do.
1040	8 x 11	8½ x 11	2	...do	Do.
Schedule A, 1040	8 x 11	8½ x 11	4	...do	Do.
Schedule B, 1040	8 x 11	8½ x 11	2	...do	Do.
Schedule C, 1040	8 x 11	8½ x 11	4	...do	Do.
Schedule D, 1040	8 x 11	8½ x 11	4	...do	Do.
Schedule E, 1040	8 x 11	8½ x 11	2	.. do	Do.
Schedule F, 1040	8 x 11	8½ x 11	4	...do	Do.
Schedule G, 1040	8 x 11	8½ x 11	4	...do	Do.
Schedule R, 1040	8 x 11	8½ x 11	2	...do	Do.
Schedule SE, 1040 [3]	8 x 11	8½ x 11	2	...do	Do.
Schedule T, 1040	8 x 11	8½ x 11	1	...do	Do.
1040C	7⅞ x 11	8½ x 11	4	...do	Do.
1041	8 x 11	8½ x 11	2	Pink	Do.
Schedule D, 1041	8 x 11	8½ x 11	4	...do	Do.
Schedule E, 1041 [4]	8 x 3½		5	...do	Do.
Schedule J, 1041	8 x 11	8½ x 11	2	...do	Do.
1065	8½ x 11		4	Yellow	Do.
Schedule D, 1065	8½ x 11		2	...do	Do.
1118	11 x 8½		2	White	Do.
1120	8½ x 11		4	Blue	Do.
Schedule D, 1120	8½ x 11		2	...do	Do.
1120–S	8½ x 11		4	Green	Do.
Schedule D, 1120–S	8½ x 11		2	...do	Do.
1122	8½ x 11		1	Blue	Do.
1138	8½ x 11		2	White	Do.
1139	8 x 11	8½ x 11	2	...do	Do.

[1] Sizes shown are for single forms furnished by Internal Revenue Service offices; detached size of forms supplied in the individual income tax packages are 8 x 11 inches.
[2] Forms cannot exceed sizes shown, nor be less than size of official forms.
[3] Schedule SE is printed as pp. 3 and 4 of schedules C and F.
[4] This is a 3-part snapout with a ½- to ¾-inch left-hand stub.

SEC. 7. REPRODUCTION PROOFS.

Order blanks for reproduction proofs will be mailed to requesters of record and, on request, to prospective users. Printers and others wishing to obtain reproduction proofs may send their requests to the Commissioner, Internal Revenue Service, Washington, D.C. 20224, Attention: A:FM:P.

A charge of $0.75 per page will be made for each reproduction proof regardless of page size. After an order has been filled, invoices will be mailed to the consignee.

Reproduction proofs are available for the following forms:

Form	*Form*
1040.	
Schedule A (1040).	Schedule F (1040).
Schedule B (1040).	Schedule G (1040).
Schedule C (1040).	Schedule J (1041).
Schedule D (1040).	1065.
Schedule E (1040).	Schedule D (1065).
Schedule R (1040).	1120.
Schedule T (1040).	Schedule D (1120).
1041.	
Schedule D (1041).	1120–S.
Schedule E (1041).	Schedule D (1120–S).

SEC. 8. EFFECT ON OTHER DOCUMENT.

This Revenue Procedure supersedes Revenue Procedure 68–36, C.B. 1968–2, 922.

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26 CFR 601.104: Collection functions. (Also Part I, Sections 6151, 6155; 20.6151–1, 301.6155–1.)

Procedure for using certain Treasury bonds in payment of Federal estate tax; Revenue Ruling 54–113 superseded and Revenue Ruling 156 superseded in part.

Rev. Proc. 69–18

SECTION 1. PURPOSE

The purpose of this Revenue Procedure is to announce procedures for using certain Treasury bonds in payment of Federal estate tax pursuant to instructions issued by the Bureau of the Public Debt.

SEC. 2. BACKGROUND

Section 20.6151–1(c) of the Estate Tax Regulations provides that Treasury bonds of certain issues which were owned by the decedent at the time of his death or which were treated as part of his estate under the rules contained in section 306.28 of Treasury Department Circular No. 300, Current Revision (31 CFR Part 306), may be redeemed at par plus accrued interest for the purpose of payment of the estate tax, as provided in such section. Whether bonds of particular issues may be redeemed for this purpose will depend on the terms of the offering circulars cited on the face of the bonds. A current list of eligible issues (Form P.D. 800–B) may be obtained from any Federal Reserve bank or branch, or from the Bureau of the Public Debt, Division of Loans and Currency,

Treasury Department, Washington, D.C. 20226.

SEC. 3. PROVISION FOR REDEMPTION AT PAR

.01 Certain Treasury Department circulars provide that the marketable bonds issued thereunder, owned by the decedent at the time of his death and which constituted part of his estate, may be redeemed at the option of the legal representatives of, or the persons entitled to, the decedent's estate at face (par) amount, plus accrued interest to the date of payment, provided the Secretary of the Treasury is authorized to apply the entire proceeds of redemption to payment of the Federal estate tax.

.02 If a bond is in a denomination too large for application of the entire proceeds in payment of the tax due from the deceased owner's estate, but is not in the lowest authorized denomination, denominational exchange will be permitted so that bonds totaling the denominational amount next lower than the tax liability may be available for such purpose. For example, if a $10,000 4¼ percent Treasury bond, interest payable on May 15 and November 15, were submitted on August 15, in payment of a Federal estate tax liability of $10,000, at which time the accrued interest from the last interest payment date to the redemption date would be $106.25 and the lowest denomination in which such bonds are issued is $500, the bond would be redeemed to the extent of $9,500 par value, with accrued interest of $100.94, and applied toward payment of the tax liability. A $500 denomination bond would be reissued for the portion of the bond which could not be applied to payment of the tax.

SEC. 4. WHERE TO SUBMIT BONDS

Form PD 1782, Application for Redemption of Treasury Bonds for Federal Estate Tax Credit, should be used in transmitting eligible Treasury bonds for redemption at par and submitted to (a) any Federal Reserve bank or branch (b) the Office of the Treasurer of the United States, Securities Division, Washington, D.C. 20220, or, (c) the Bureau of the Public Debt, Division of Loans and Currency, Washington, D.C. 20226, preferably a month in advance of the date specified for redemption. Copies of Form PD 1782 may be obtained from any Federal Reserve bank or branch, or from the Bureau of the Public Debt.

SEC. 5. REDEMPTION DATE

.01 The legal representative of, or if none was appointed a person authorized by those entitled to share in, the estate should designate on Form PD 1782 the date as of which the Treasury bonds are to be redeemed in payment of the tax shown to be due on the estate tax return or in pyament of an estate tax deficiency (including interest, penalties, and any accrued interest charge where the redemption date of the bond is after the tax due date).

.02 Redemption may be requested as of the date the Federal estate tax is due or a date prior or subsequent to the date the tax is due. When a redemption date subsequent to the date on which the taxes are due is requested, see section 6601 of the Internal Revenue Code of 1954, relating to interest due on underpayments of tax. The bonds and Form PD 1782 must be presented on or before the redemption date requested on the form, but not more than three months before such date. If so presented, the bonds will be redeemed as of the requested redemption date. If the bonds and Form PD 1782 are received after the requested redemption date, the bonds will be redeemed as of the date of receipt. Where no redemption date is specified but the bonds and Form PD 1782 are received prior to the date the tax is due, the bonds will be redeemed on or as of the tax due date; however, if received after the date the tax is due, the bond will be redeemed as of the date of receipt.

SEC. 6. SUBSTITUTION

Where the estate tax was paid (other than by use of eligible Treasury bonds) but eligible Treasury bonds are available for redemption at par for payment of the tax, substitution may be made of the proceeds from the redemption of such eligible bonds to the extent of the amount otherwise paid. However, substitution may not be made after the estate has been distributed, or after the expiration of two years from the time the tax is paid, whichever occurs the earlier.

SEC. 7. DATE PAYMENT IS MADE

Except in the case of redemption by substitution, the effective redemption date as provided in section 5.02 shall be considered the date the payment is made. See Rev. Rul. 69–489, page 9, this Bulletin. The effective redemption date will be reflected on Form 15, Certificate of Deposit. In the case of redemption by substitution, the date of payment is the date the estate tax was paid other than by use of eligible Treasury bonds. See Rev. Rul. 69–489.

SEC. 8. EFFECT ON OTHER DOCUMENTS

This Revenue Procedure supersedes Revenue Ruling 54–113, C.B. 1954–1, 202, and also supersedes that part of Revenue Ruling 156, C.B. 1953–2, 253, covering the procedures and instructions that relate to the redemption of certain Treasury bonds in payment of Federal estate tax.

SEC. 9. INQUIRIES

Any inquiries with respect to sections 1 through 6 should be directed to the Bureau of the Public Debt, Division of Loans and Currency, Treasury Department, Washington, D.C. 20226.

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26 CFR 601.201: Rulings and determination letters.
(Also Part 1, Sections 351, 367; 1.351–1, 1.367–1.)

The conditions or circumstances under which the Revenue Service will issue an advance ruling under section 367 of the Code that an agreement which purports to furnish technical "know-how" in exchange for stock is a transfer of property under section 351.

Rev. Proc. 69–19

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth the conditions or circumstances under which, for pur-

poses of advance rulings under section 367 of the Internal Revenue Code of 1954, the Internal Revenue Service will issue a ruling that an agreement which purports to furnish technical "know-how" in exchange for stock is a transfer of property within the meaning of section 351 of the Code.

SEC. 2. BACKGROUND.

.01 In order for a secret process, formula, or other secret information (often referred to as technical "know-how," and hereinafter referred to simply as "information") to qualify as property that can be transferred, without recognition of gain or loss, in exchange for stock or securities under section 351 of the Code, Revenue Ruling 64–56, C.B. 1964–1 (Part I), 133, provides in part that (1) the consideration from the transferor (the "information") must actually qualify as property within the meaning of sections 861(a)(4) and 862(a)(4) of the Code rather than personal services in the form of technical assistance and (2) the country in which the transferee is to operate must afford to the transferor substantial legal protection against the unauthorized disclosure and use of the "information."

.02 These requirements encompass issues of both fact and law. Resolution of these issues requires factual information and determinations, making it difficult to issue an unqualified ruling before the transaction has been consummated. Nevertheless, in spite of such difficulties, it is in the interest of sound tax administration to continue to answer inquiries of taxpayers on these issues. Therefore, the Service upon request will continue to issue rulings on these transactions provided the taxpayer can in good faith make certain factual representations in his application regarding the issue based upon information that would be readily available to the Service upon request.

SEC. 3. STATEMENTS TO BE INCLUDED IN RULING REQUESTS.

.01 Ordinarily, for purposes of advance rulings under section 367 of the Code where the request involves the transfer of "information" in exchange for stock under section 351, the Service will accept appropriate representations referred to in section 2.02 above. If appropriate, statements as follows should be included in the request for ruling:

"It is represented that the 'information' being transferred in exchange for stock under section 351 is 'property' within the meaning of Revenue Ruling 64–56, C.B. 1964–1 (Part I), 133, and as such is afforded substantial legal protection against unauthorized disclosure and use under the laws of the country from which it is being transferred. It is further represented that any services to be performed in connection with the transfer of the property are merely ancillary and subsidiary to the property transfer within the meaning of Revenue Ruling 64–56 or the transferor will be compensated by a fee negotiated at arm's length (in consideration other than stock or securities of the transferee unless such stock or securities are identified) for any other services to be performed on behalf of the transferee."

.02 In making such representations the taxpayer should in his request for ruling describe the "information" involved and state that:

(a) the "information" is secret in that it is known only by the owner and those confidential employees who require the "information" for use in the conduct of the activities to which it is related and adequate safeguards have been taken to guard the secret against unauthorized disclosure, and

(b) the "information" represents a discovery and, while not necessarily patentable, the "information" is original, unique, and novel.

.03 The statements and representations described in .01 and .02 above must be based upon the following criteria and facts and the request for a ruling should affirmatively state the presence or absence of such criteria or facts by reference to this subsection of this Revenue Procedure:

(a) The "information" is not revealed by a patent, is not the subject of a patent application, nor is it disclosed by the product on which it is used or to which it is related.

(b) The "information" does not represent mere knowledge, or efficiency resulting from experience, or mere skill in manipulation or total accumulated experience and skill of the transferor.

(c) The "information" involved is not merely the rights to tangible evidence of information such as blueprints, drawings or other physical material on which it is recorded.

(d) The "information" has not been developed especially for the transferee.

(e) The "information" is not in the form of assistance in the construction of a plant building or advice as to the layout of machinery and equipment.

(f) The "information" is not training of the transferee's employees that is essentially educational in nature.

(g) Technical information of a related or similar nature such as new developments in the field will not be furnished on a continuing basis without adequate compensation therefor in the manner prescribed for services in the statement in subsection .01 above.

.04 Any other information that may be considered pertinent by the Service in connection with the factual representations should also be readily available upon request.

SEC. 4. CONCLUSION.

If the above representations are made by the transferor the Service will consider for purposes of the requested ruling that the country in which the transferee is to operate affords to the transferor substantial legal protection against the unauthorized disclosure and use of the information.

SEC. 5. EFFECT ON OTHER DOCUMENTS.

These procedures have no effect upon the substantive provisions and requirements of Revenue Ruling 64–56. Also, the representations and any other facts upon which the ruling letter is based will be subject to verification by the District Director in connection with the examination of the taxpayer's Federal income tax return.

26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 401, 501; 1.401–1, 1.501(a)–1.)

Revenue Procedure 68–45 is amplified to set forth the procedure for issuance of opinion letters involving the definition of "compensation" in master or prototype pension, annuity and profit-sharing plans under section 401(a) of the Code that integrate with social security benefits.

Rev. Proc. 69–20

Revenue Procedure 68–45, C.B. 1968–2, 957, sets forth the general procedures of the Internal Revenue Service pertaining to the issuance of rulings, determination letters, and opinion letters relating to master and prototype pension, annuity, and profit-sharing plans (except those covering self-employed individuals) under section 401(a) of the Internal Revenue Code of 1954, and the status for exemption of related trusts or custodial accounts under section 501(a).

In master or prototype plans that involve integration with Social Security benefits, it is impossible to determine in advance whether in an individual case a particular restrictive definition of the compensation (such as basic compensation) on which contributions or benefits are based would result in 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. See Revenue Ruling 69–503, page 94, this Bulletin. As to discrimination in contributions or benefits generally, see section 1.401–4(a)(1)(i) of the Income Tax Regulations.

Accordingly, opinion letters relating to master or prototype plans that involve integration with Social Security benefits will not be issued except for those plans where annual compensation, for the purposes of sections 3.01, 6.02, 6.02, 6.03, 13.01, 13.02, and 14.02 of Revenue Ruling 69–4, C.B. 1969–1, 18, is defined to be all of each employee's compensation that would be subject to tax under section 3101(a) of the Code without the dollar limitation of section 3121(a)(1) of the Code.

Revenue Procedure 68–45 is hereby amplified.

(Also Part I, Section 162; 26 CFR 1.162–4, 1.162–11.)

Guidelines in connection with the examination of Federal income tax returns involving costs incurred to develop, purchase, or lease computer software.

Rev. Proc. 69–21 [1]

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to provide guidelines to be used in connection with the examination of Federal income tax returns involving the costs of computer software.

SEC. 2. BACKGROUND.

For the purpose of this Revenue Procedure, "computer software" includes all programs or routines used to cause a computer to perform a desired task or set of tasks, and the documentation required to describe and maintain those programs. Computer programs of all classes, for example, operating systems, exceutive systems, monitors, compilers and translators, assembly routines, and utility programs as well as application programs are included. "Computer software" does not include procedures which are external to computer operations, such as instructions to transcription operators and external control procedures.

SEC. 3. COSTS OF DEVELOPING SOFTWARE.

.01 The costs of developing software (whether or not the particular software is patented or copyrighted) in many respects so closely resemble the kind of research and experimental expenditures that fall within the purview of section 174 of the Internal Revenue Code of 1954 as to warrant accounting treatment similar to that accorded such costs under that section. Accordingly, the Internal Revenue Service will not disturb a taxpayer's treatment of costs incurred in developing software, either for his own use or to be held by him for sale or lease to others, where:

1. All of the costs properly attributable to the development of software by the taxpayer are consistently treated as current expenses and deducted in full in accordance with rules similar to those applicable under section 174(a) of the Code; or

2. All of the costs properly attributable to the development of software by the taxpayer are consistently treated as capital expenditures that are recoverable through deductions for ratable amortization, in accordance with rules similar to those provided by section 174(b) of the Code and the regulations thereunder, over a period of five years from the date of completion of such development or over a shorter period where such costs are attributable to the development of software that the taxpayer clearly establishes has a useful life of less than five years.

SEC. 4. COSTS OF PURCHASED SOFTWARE.

.01 With respect to costs of purchased software, the Service will not disturb the taxpayer's treatment of such costs if the following practices are consistently followed:

1. Where such costs are included, without being separately stated, in the cost of the hardware (computer) and such costs are treated as a part of the cost of the hardware that is capitalized and depreciated; or

2. Where such costs are separately stated, and the software is treated by the taxpayer as an intangible asset the cost of which is to be recovered by amortization deductions ratably over a period of five years or such shorter period as can be established by the taxpayer as appropriate in any particular case if the useful life of the software in his hands will be less than five years.

SEC. 5. LEASED SOFTWARE.

Where a taxpayer leases software for use in his trade or business, the Service will not distrub a deduction allowable under the provisions of section

[1] Also released as Technical Information Release 1021, dated October 7, 1969.

1.162–11 of the Income Tax Regulations, for rental.

SEC. 6. APPLICATION.

.01 The costs of development of software in accordance with the above procedures will be treated as a method of accounting. Any change in the treatment of such costs is a change in method of accounting subject to the provisions of sections 446 and 481 of the Code and the regulations thereunder.

.02 For taxable years ending after October 27, 1969, the date of publication of this Revenue Procedure, the Service will not disturb the taxpayer's treatment of software costs that are handled in accordance with the practices described in this Revenue Procedure.

.03 For taxable years ending prior to the date of publication of this Revenue Procedure, the Service will not disturb the taxpayer's treatment of software costs except to the extent that such treatment is markedly inconsistent with the practices described in this Revenue Procedure. For the purpose of applying the preceding sentence, the absence of any formal election similar to that required by section 174 of the Code, or the amortization of capitalized software costs over a period other than the five-year period specified in section 174(b) of the Code, will not characterize the taxpayer's treatment of such costs as markedly inconsistent with the principles of this Revenue Procedure.

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26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations. (Also Part III–A, Section 7805; 301.7805–1.)

Procedures are provided for the qualification and certification of chemists and laboratories desiring to analyze distilled spirits that are to be exported to foreign countries; Revenue Procedure 65–9 superseded in part and Revenue Procedure 65–24 superseded.

Rev. Proc. 69–22

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to establish procedures for the qualification and certification of chemists and laboratories desiring to analyze distilled spirits that are to be exported to foreign countries.

SEC. 2. BACKGROUND.

Many countries require that imported distilled spirits be chemically analyzed before their customs authorities may release them into commercial channels. Some of these countries provide that such spirits must be analyzed by their own government laboratories or by laboratories certified by their government. Others permit the analysis to be made in the exporting country, as long as such analysis is made by a chemist or laboratory certified as qualified to perform such analysis by the government of the exporting country. Italy is one such country in the latter category, and Revenue Procedure 65–9, C.B. 1965–1, 735, as amended by Revenue Procedure 65–24, C.B. 1965–2, 1006, established procedures whereby the Director, Alcohol, Tobacco and Firearms Division, could certify that chemists or laboratories were qualified to analyze distilled spirits to be exported to that country. The Service has been requested to provide similar procedures with respect to distilled spirits to be exported to countries other than Italy.

SEC. 3. APPLICATION FOR CERTIFICATION.

Applications for certification that a chemist or laboratory is qualified to analyze distilled spirits to be exported, may be filed by a graduate chemist, by a laboratory under the direction of a graduate chemist, or by an exporter on behalf of such a chemist or laboratory. The application shall be filed in duplicate, on the applicant's letterhead, with the Director, Alcohol, Tobacco and Firearms Division, Internal Revenue Service, Washington, D.C. 20224. It will be supported by documentation of the graduate chemist's educational qualifications and professional experience (this information may be subject to verification). Chemists or laboratories already certified by the Director under the provisions of Revenue Procedure 65–9 need not again apply for certification. They will automatically be considered qualified to analyze distilled spirits under this Revenue Procedure, and their names will be included on the lists of certified chemists and laboratories to be distributed by the Director.

SEC. 4. QUALIFICATION FOR CERTIFICATION.

.01 To qualify for certification by the Director, Alcohol, Tobacco and Firearms Division, the chemist or laboratory must:

(a) Have access to such laboratory equipment and facilities as may be necessary to analyze distilled spirits according to the techniques described in subdivisions (1)–(10) of the following subparagraph (b). The adequacy of such equipment and facilities may be subject to verification or inspection.

(b) Submit to the Director, Alcohol, Tobacco and Firearms Division (Attention: National Office Laboratory), Internal Revenue Service, Washington, D.C. 20224, a report of the analysis of any sample of straight whisky and any sample of blended whisky, together with a one-pint sample of each of the whiskies analyzed. This report should show the following with respect to each sample:

(1) *Proof and Percent Alcohol by Volume,* as determined using the techniques described in 26 CFR 186.31 and 186.32 (Gauging Manual of the U.S. Treasury Department, Internal Revenue Service, 1962 edition). Proof should be reported to the nearest 0.1° proof; percent alcohol by volume to the nearest 0.05%.

(2) *Specific Gravity* in air at 60° F., as calculated from the proof, table 6 of the Gauging Manual (1962 edition). Report to the nearest 0.00001.

(3) *Methyl Alcohol,* as determined using the chromotropic acid colorimetric method described at sections 9.051–9.054 of the Official Methods of Analysis of the Association of Official Agricultural Chemists (OMA, 10th edition). The determination will be made on a straight distillate from the sample, without concentration of the methyl alcohol as provided for in the

atter half of section 9.053. Report to the nearest 0.1 cc per 100 cc anhydrous alcohol.

(4) *Total Solids,* as determined using the techniques described at section 9.023 of the OMA, 10th edition. Report to the nearest 0.1 mg per 100 cc anhydrous alcohol.

(5) *Total Acidity* (as acetic acid), as determined using the techniques described at section 9.030 of the OMA, 10th edition. Report to the nearest 0.1 mg per 100 cc anhydrous alcohol.

(6) *Esters* (as ethyl acetate), as determined using the techniques described at sections 9.034–9.035 of the OMA, 10th edition, or the gas liquid chromatographic method as described in *51* 456–457(1968) of the Journal of the Association of Official Analytical Chemists. Report to the nearest 0.1 mg per 100 cc anhydrous alcohol.

(7) *Aldehydes,* as determined using the techniques described at sections 9.034 and 9.036 of the OMA, 10th edition. Report to the nearest 0.1 mg per 100 cc anhydrous alcohol.

(8) *Furfural,* as determined using the techniques described at sections 9.046 and 9.047 of the OMA, 10th edition. Report to the nearest 0.1 mg per 100 cc anhydrous alcohol.

(9) *Higher Alcohol* (fusel oil), as determined using the P-Dimethylaminobenzaldehyde method as described at sections 9.037–9.039 of the OMA, 10th edition, the 4-Hydroxybenzaldehyde-3-sulfonic acid method as described at sections 9.040–9.045 of the OMA, 10th edition, or the gas liquid chromatographic method as described in *51* 456–457(1968) of the Journal of the Association of Official Analytical Chemists. Report to the nearest 0.1 mg per 100 cc anhydrous alcohol.

(10) *Total Secondary Products* (volatile impurities) calculated as the sum total of items (5), (6), (7), (8), and (9). Report to the nearest 0.1 mg per 100 cc anhydrous alcohol.

(c) Submit to the Director, Alcohol, Tobacco and Firearms Division, a report of the analysis (performed in accordance with subdivision (3) above) of the methyl alcohol content of a sample that will be furnished by the Director. A sample is furnished in this instance because methyl alcohol will usually not be present in the straight and blended whiskies analyzed under subparagraph (b) above.

SEC. 5. CERTIFICATION OF APPLICANTS.

If U.S. Government chemists verify the reports of analysis submitted by the applicant, and other requirements have been met, the Director, Alcohol, Tobacco and Firearms Division, will certify the laboratory or chemist and so notify the applicant. Any person, agency of a foreign government, etc., desiring to obtain a list of the chemists and laboratories so certified, should submit a request for such list to the Director, Alcohol, Tobacco and Firearms Division. If the laboratory or chemist does not meet the requirements for certification, the applicant will be so notified.

SEC. 6. ANALYSES BY CERTIFIED CHEMISTS OR LABORATORIES.

Certified chemists or laboratories will perform their analyses of distilled spirits using the techniques described at subdivisions 4.01(b)(1)–4.01(b)(10) of this Revenue Procedure. Where tests other than those listed are required by a foreign government, the Director, Alcohol, Tobacco and Firearms Division, may, upon application in duplicate, authorize the reporting of data relating to such additional tests on the certificate of analysis. Approval of such applications may be conditioned upon compliance with any additional qualifying requirements the Director may prescribe.

SEC. 7. CERTIFICATES OF ANALYSIS.

.01 Certificates of analysis will be signed by the certified chemist, or, where a laboratory under the direction of a graduate chemist has been certified by the Director, by such graduate chemist. Directly under his signature, the chemist may enter the designation "Chemist certified by United States Internal Revenue Service under Revenue Procedure 69–22."

.02 As an alternative, where the certificate of analysis is being prepared for a country that requires a statement by a governmental authority of the exporting country on the certificate of analysis, the following procedure may be followed. The signed certificate will be forwarded to the Internal Revenue Officer assigned to the distilled spirits plant at which the spirits were bottled or packaged, or, where no officer is assigned to such plant, to the Assistant Regional Commissioner, Alcohol, Tobacco and Firearms. The assigned officer or Assistant Regional Commissioner may, if the chemist or laboratory making the analysis has been duly certified by the Director, Alcohol, Tobacco and Firearms Division, attest as follows on the certificate of analysis: "I hereby attest that (name of certified chemist or laboratory) is duly certified to make analyses under Revenue Procedure 69–22 of the U.S. Treasury Department, Internal Revenue Service." One copy of the certificate of analysis will be retained by the assigned officer or Assistant Regional Commissioner, and the remaining copy or copies will be forwarded to the exporter.

SEC. 8. EFFECT ON OTHER DOCUMENTS.

Sections 1, 2, 3, and 5 of Revenue Procedure 65–9, C.B. 1965–1, 735, and Revenue Procedure 65–24, C.B. 1965–2, 1006, are hereby superseded.

SEC. 9. INQUIRIES.

Inquiries regarding this Revenue Procedure should refer to its number and be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol, Tobacco and Firearms.

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26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations. (Also Part III–A, Section 7805; 252.104.)

Section 4 of Revenue Procedure 65–9, relating to modification of Form 2177, Certificate of Origin and Age of Distilled Spirits, to meet the importation requirements of the Italian Government is restated; Revenue Procedure 65–9 superseded in part.

Rev. Proc. 69–23

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to provide for modifying

Form 2177, Certificate of Origin and Age of Distilled Spirits, so that it meets the importation requirements of the Italian Government.

SEC. 2. BACKGROUND.

.01 Certain foreign governments permit the entry of distilled spirits into their country only upon the filing of an official certificate showing the origin and age of the spirits. Recognizing this requirement, 26 CFR 252.104 provides a procedure whereby Internal Revenue Officers may furnish such a certificate (on Form 2177).

.02 The Italian Government requires a certificate of origin and age for imported distilled spirits, but the information they require to be shown differs from that called for on Form 2177. Revenue Procedure 65–9, C.B. 1965–1, 735, provided, in part, for modifying Form 2177 to meet the needs of the Italian Government.

.03 The portion of Revenue Procedure 65–9 that did not relate directly to Form 2177 has been superseded by Revenue Procedures 69–22, page 304, this Bulletin. In order to declare Revenue Procedure 65–9 obsolete, the portion relating to certificates of origin and age (Section 4) is superseded and restated as follows:

SEC. 3. CERTIFICATE OF ORIGIN AND AGE.

.01 Form 2177 will be modified by the exporter to the extent necessary to reflect the information required by the Italian Government. It will be identified as being prepared specifically for the Italian Government and will include:

1st Line—Name and address of producer.

2d Line—Name and address of exporter.

3d Line—Name and address of Italian consignee.

Column (a)—Name and trademark of the product.

Column (a)—Number of bottles and receptacles.

Column (a)—Number of gallons.

Column (a)—Number of proof gallons.

Column (b)—Number of packages.

Column (c)—Class and type.

Column (d)—Date produced.

Column (e)—Type of cooperage.

Column (f)—Months stored in bond.

.02 If the spirits are blended whiskies, an entry will be made on the Form 2177 at an available space below the line designated "Description of Spirits," identifying the age of the straight whisky, or of the youngest straight whisky in the blend if there is more than one; and the percent of straight whisky, other whisky, and neutral spirits in the blend.

.03 The Internal Revenue Officer assigned to the premises will sign Form 2177 as evidence of certification of the entries thereon. In the event an Internal Revenue Officer is not assigned to the premises, the Form 2177 will be forwarded to the Assistant Regional Commissioner, Alcohol, Tobacco and Firearms, of the region in which the bottler is located, for verification. Before signing Form 2177, sufficient investigation will be made to assure the completeness and accuracy of the entries on the form.

SEC. 4. EFFECT ON OTHER DOCUMENTS

Section 4 of Revenue Procedure 65–9, C.B. 1965–1, 735, is hereby superseded.

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, Tobacco and Firearms.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 401, 405, 501; 1.401–1, 1.405–1, 1.501(a)–1.)

Elimination of advance determinations by District Directors as to qualifications of plans that include self-employed individuals where employers adopt master or prototype plans previously approved as to form, and discontinuance of the use of Form 3673; Revenue Procedure 69–5 modified.

Rev. Proc. 69–24

SECTION 1. PURPOSE.

This Revenue Procedure modifies Revenue Procedure 69–5, C.B. 1969–1, 395, to limit the extent to which District Directors will issue determination letters (1) on pension and profit-sharing plans that include self-employed individuals, under section 401 of the Internal Revenue Code of 1954, as amended by Public Law 87–792, C.B. 1962–3, 89, and (2) on the status for exemption from Federal income tax of related trusts and custodial accounts under section 501(a) of the Code.

SEC. 2. BACKGROUND AND GENERAL INFORMATION.

.01 Public Law 87–792, the Self-Employed Individuals Tax Retirement Act of 1962, effective for taxable years beginning after December 31, 1962, provides certain tax benefits in connection with pension, profit-sharing, and bond purchase plans that include self-employed individuals and that meet the applicable requirements of section 401 or 405(a) of the Code. A related trust or custodial account, if any, is exempt from taxation as provided in section 501(a) of the Code.

.02 A determination letter as to the qualification of a pension, profit-sharing, or bond purchase plan, and the exempt status of any related trust is not required as a condition for obtaining the tax benefits pertaining to the plan or trust. However, section 3.03 of Revenue Procedure 69–5, authorizes District Directors of Internal Revenue to issue determination letters, upon request, as to the qualification of individually designed plans. Also, under these procedures an employer adopting a master or prototype plan previously approved as to form and requesting a determination has been required to file Form 3673, Application for Approval of Self-Employed Pension or Profit-Sharing Plan as Part of a Master or Prototype Form or any Bond Purchase Plan. If the request involved a bond purchase plan, the requirement has been for proper completion of only Parts I and III of Form 3673, which constituted a bond purchase plan.

.03 Adopting the procedures for prior approval of the forms of master and prototype plan arrangements was prompted by the substantial number of self-employed individuals who were expected to, and in fact did, avail themselves of the tax benefits provided by P.L. 87–792.

.04 An analysis of the pension and profit-sharing activities with respect to the use of Form 3673 indicates that there is no necessity of separate approval of each employer's application.

SEC. 3. DETERMINATION LETTERS.

.01 District Directors will no longer make advance determinations regarding plans of employers who adopt a master or prototype plan, or any related prototype trust or custodial account, previously approved as to form. Accordingly, the use of Form 3673 is discontinued.

.02 District Directors will continue to make determinations, upon request, of self-employed individuals who adopt a bond purchase plan. A new application, Form 4578, Application for Approval of Bond Purchase Plan, will be used for this purpose.

.03 District Directors will also continue to issue determination letters, upon request, as to the qualification of individually designed plans under the general procedures of Revenue Procedure 69–4, C.B. 1969–1, 391.

SEC. 4. STATUS OF PLAN AND RELATED TRUST OR CUSTODIAL ACCOUNT.

Where an employer adopts a master or prototype plan and any related prototype trust or custodial account previously approved as to form, and observes the provisions thereof, such plan and trust or custodial account will be deemed to satisfy the requirements of sections 401 and 501(a) of the Code, provided the eligibility requirements and contributions or benefits under the plan for owner-employees are not more favorable than for other employees, including those required to be covered under plans of all businesses controlled by such owner-employees.

SEC. 5. EFFECT OF OTHER DOCUMENTS.

Revenue Procedure 69–5 is hereby modified to provide that District Directors will no longer make advance determinations regarding plans of employers who adopt a master or prototype plan, or related prototype trust or custodial account, previously approved as to form.

SEC. 6. EFFECTIVE DATE.

This Revenue Procedure is effective November 3, 1969, the date of its publication in the Internal Revenue Bulletin. However, Forms 3673 received on or before this date will be processed under prior procedures.

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26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations. (Also Part III–A, Sections 5053, 5062, 245.170, 252.23.)

South Africa has been added to the list of foreign countries to which reciprocal privileges involving the withdrawal of liquors free of tax or with benefit of drawback for use on aircraft may be extended, and exception to reciprocal privileges stated as to four other countries; Revenue Procedure 69–15 superseded.

Rev. Proc. 69–25

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to announce the addition of South Africa to the list of foreign countries to which the reciprocal privileges provided by section 309 of the Tariff Act of 1930, 19 U.S.C. 1309, as amended, may be extended, and to announce that ground equipment may not be withdrawn under section 309 (a)(3) of the Tariff Act of 1930, as amended, for aircraft registered in Canada, the Federal Republic of Germany, Italy, and the United Kingdom.

SEC. 2. BACKGROUND.

Under the provisions of section 309 of the Tariff Act of 1930, as amended, and sections 5053, 5055, 5062(b), 5214(a)(7), and 5362(c)(3) of the Internal Revenue Code of 1954, and applicable regulations of the Internal Revenue Service, alcohol, distilled spirits, beer, and wine may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft registered in foreign countries and actually engaged in foreign trade or trade between the United States and its possessions, or between Hawaii and any other part of the United States, or between Alaska and any other part of the United States where trade by foreign aircraft is permitted. Such privilege is extended in respect of aircraft registered in a foreign country only if the Secretary of Commerce has found that such foreign country allows, or will allow, substantially reciprocal privileges in respect of aircraft registered in the United States.

SEC. 3. SOUTH AFRICA.

In addition to those countries listed in Revenue Procedure 69–15, page 287, this Bulletin, the Secretary of Commerce has found and has advised the Secretary of the Treasury that, except for ground equipment, the country of South Africa extends to aircraft registered in the United States and engaged in foreign trade privileges substantially reciprocal to those given aircraft registered in South Africa and engaged in foreign trade. Corresponding privileges are, therefore, extended to aircraft registered in South Africa and engaged in foreign trade.

SEC. 4. GROUND EQUIPMENT

Revenue Procedure 69–15 lists the countries of Canada, the Federal Republic of Germany, Italy, and the United Kingdom, without exception as to ground equipment, as countries to which reciprocal privileges may be extended. The Secretary of Commerce has now found and has advised the Secretary of the Treasury that those countries do not allow exemption from tax on ground equipment brought in for aircraft of United States registry engaged in foreign trade. Therefore, effective May 1, 1969, as to Canada and the Federal Republic of Germany, effective June 25, 1969, as to the United Kingdom, and effective September 23, 1969, as to Italy, ground equipment may not be withdrawn under section 309(a)(3) of the Tariff Act of 1930, as amended, for aircraft registered in such foreign countries.

The listing in Section 5 of this Revenue Procedure reflects these changes.

SEC. 5. COMPLETE LIST OF FOREIGN COUNTRIES.

The complete list of foreign countries to which reciprocal privileges may be extended is as follows:

Argentina	Italy*
Australia	Japan
Bahama Islands	Lebanon
Belgium	Mexico
Bermuda	Netherlands
Brazil	Nicaragua
Canada*	Norway
Chile	Pakistan
Costa Rica	Panama
Denmark	Peru
Dominican Republic	Portugal*
Ecuador	South Africa*
Eire	Spain
El Salvador	Sweden
Finland	Switzerland
France	Trinidad and Tobago
Germany, Federal Republic of*	Union of Soviet Socialist Republics
Greece	United Kingdom*
India	Venezuela
Israel	

* Except for ground equipment.

SEC. 6. EFFECT ON OTHER DOCUMENTS.

This Revenue Procedure supersedes Revenue Procedure 69–15, page 287, this Bulletin.

SEC. 7. INQUIRIES.

Any inquiries concerning this Revenue Procedure should refer to its number and be addressed to the appropriate Assistant Regional Commissioner, Alcohol, Tobacco and Firearms.

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26 CFR 601.104: Collection functions. (Also Part I, Section 6672; 301.6672–1.)

Elimination of the administrative appeals in certain unagreed employment and excise tax cases arising in District Collection Divisions involving 100-percent penalty under section 6672 of the Code; Revenue Procedure 57–26, as amplified by Revenue Procedure 61–27, modified.

Rev. Proc. 69–26

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to eliminate administrative appeals procedure in certain cases arising in District Collection Divisions involving section 6672 of the Internal Revenue Code of 1954 (or corresponding provisions of the Internal Revenue Code of 1939).

SEC. 2. BACKGROUND.

.01 Section 6672 of the Code imposes a penalty (hereinafter referred to as the 100-percent penalty) against any person who, being required to collect, truthfully account for, and pay over any tax imposed by the Code, willfully fails to collect such tax, or truthfully account for any pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof.

.02 The term "person," as used herein, includes an officer or employee of a corporation, or a member or employee of a partnership who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs. See section 6671(b) of the Code.

.03 Revenue Procedure 57–26, C. B. 1957–2, 1093, extended jurisdiction of the Appellate Division, prior to assessment, to all unagreed cases arising in District Audit Divisions which involve excise taxes imposed under Chapters 31, 32, 33, 34, 36, 37, Subchapter F of Chapter 38, and Subchapters B, C, D, E, and F of Chapter 39, and employment taxes under Chapters 21, 22, 23 and 24 of the Internal Revenue Code of 1954 and corresponding provisions of the Internal Revenue Code of 1939. Revenue Procedure 61–27, C.B. 1961–2, 563, amplified Revenue Procedure 57–26 so as to extend jurisdiction of the Appellate Division prior to assessment to all unagreed and protested 100-percent penalty cases arising in District Collection Divisions, except where collection of the amount involved is in jeopardy.

.04 In developing the defense of a refund suit brought by one of several responsible persons subject to an assessment under the provisions of section 6672 of the Code (or corresponding provisions of the 1939 Code), it may become necessary to determine whether a person against whom an assessment has not been made may have been a person within the meaning of section 6672 (hereinafter referred to as "responsible person"). In such circumstances, it is customary to authorize or recommend that third-party actions be instituted against such a person.

.05 In order to maintain a third-party action in such circumstances, the district director must be requested to make an assessment, since no assessment had previously been made against such party. This action is necessary to bring all potentially responsible persons before the court and let the court decide which person is responsible under section 6672.

SEC. 3. SCOPE.

The procedures set forth below are applicable to 100-percent penalty cases arising in District Collection Divisions which relate to employment and excise taxes imposed under Chapters 21, 22, 24 and 33 of the 1954 Code (or corresponding provisions of the 1939 Code), except where notice of proposed 100-percent penalty assessment has been issued and hearing rights have already been made available prior to November 17, 1969.

SEC. 4. PROCEDURE IN DISTRICT COLLECTION DIVISIONS.

.01 If the 100-percent penalty has not been assessed against all of the potentially responsible persons within the purview of section 6672 and a request for an assessment is made by the Chief Counsel in order to support a third-party action in a pending refund suit, the Collection Division of the appropriate district director's office shall immediately request an assessment of the 100-percent penalty against such potentially responsible persons. The administrative review procedures will continue to apply to those potentially responsible persons outside of the jurisdiction of the court in which the refund suit is pending.

.02 Assessments made under the foregoing conditions will not be subject to administrative appeal under District Conference procedures or before a Regional Appellate Division.

.03 The elimination of administrative appeal under District Conference

and Regional Appellate Division procedures does not deprive the person of a right to review of his case. The forum for his hearing becomes the court which will decide which person, or persons, is responsible under section 6672.

SEC. 5. EFFECT ON OTHER DOCUMENTS.

Revenue Procedure 57–26, as amplified by Revenue Procedure 61–27, is hereby modified as provided herein.

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26 CFR 601.311: Imposition of taxes; regulations.
(Also Part III–B, Section 5704; 290.200, 290.201.)

Procedures are established for documenting receipt of tobacco articles when part of a shipment is delayed during transfer between export warehouses and between factories and export warehouses.

Rev. Proc. 69–27

SECTION 1. PURPOSE.

This Revenue Procedure establishes the procedure to be followed when tobacco articles are transferred in bond to or between export warehouses or are returned to a factory from an export warehouse and part of the shipment is delayed and later delivered to the consignee.

SEC. 2. BACKGROUND.

Occasionally proprietors of export warehouses receive shipments of tobacco articles from factories or other export warehouses and find the shipment is incomplete in relation to the quantities shown on the covering Form 2149 or 2150. Manufacturers may also occasionally receive incomplete shipments of tobacco articles being returned to factories from export warehouses. The regulations in 26 CFR 290.200 and 290.201 require that immediately upon receipt of a shipment the person receiving the shipment (consignee) shall execute the certificate of receipt on each copy of the notice of removal, noting thereon any discrepancy, and return one copy of the notice to the person who made the shipment (consignor). In some instances the missing articles are later delivered to the consignee.

SEC. 3. TRANSFER TO EXPORT WAREHOUSE.

.01 When tobacco articles which have been delayed during a transfer in bond are delivered to an export warehouse after the proprietor has received part of the shipment and properly disposed of the covering Form 2149 or 2150, he will enter in his records and on his record copy of the covering Form 2149 or 2150 the quantities of articles so received and the actual date of receipt. He shall also prepare a letter, in original and three copies, to the consignor informing him of the receipt. All copies of the letter should be signed and it should identify, by serial number and date, the Form 2149 or 2150 covering the shipment from which the articles were delayed, specify the kind and quantity of articles belatedly received, and give the date of actual receipt. The original and one copy of the letter should be sent to the consignor, one copy should be submitted with the proprietor's monthly report for the month in which the delayed articles were received, and the remaining copy retained by the proprietor as part of his records.

.02 When the consignor receives the two copies of the letter he should send the original to his assistant regional commissioner to obtain relief from the tax liability on the articles accounted for (or submit it with a claim if the tax has been paid or assessed), and associate the remaining copy of the letter with the related Form 2149 or 2150 and retain it as part of his records.

SEC. 4. RETURN TO FACTORY.

.01 When the delayed portion of a shipment of tobacco articles being returned from an export warehouse is delivered to a factory after the manufacturer has received part of the shipment and properly disposed of the covering Form 2150, he will enter in his records and on his record copy of the covering Form 2150 the quantities of articles so received and the actual date of receipt. He shall also prepare a letter, in original and two copies, to the export warehouse proprietor informing him of the receipt. All copies of the letter should be signed and it should identify, by serial number and date, the Form 2150 covering the shipment from which the articles were delayed, specify the kind and quantity of articles belatedly received, and give the date of actual receipt. The original and one copy of the letter should be sent to the export warehouse proprietor, and the remaining copy should be retained by the manufacturer as part of his records.

.02 Upon receipt of the two copies of the letter the export warehouse proprietor should forward the original to his assistant regional commissioner to obtain relief from the tax liability on the tobacco articles accounted for (or submit it with a claim if the tax has been paid or assessed), and associate the remaining copy of the letter with the related Form 2150 and retain it as part of his records.

SEC. 5. INQUIRIES.

Inquiries regarding this Revenue Procedure should refer to its number and be addressed to the office of your Assistant Regional Commissioner, Alcohol, Tobacco and Firearms.

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26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations. (Also Part III–A, Sections 5062, 5214; 252.171, 252.91.)

Procedures are provided for obtaining certification as to the authenticity of straight bourbon whiskey being exported to member States of the European Economic Community.

Rev. Proc. 69–28

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to establish procedures for obtaining certification as to the authenticity of straight bourbon whiskey being exported to member States of the European Economic Community (European Common Market).

SEC. 2. BACKGROUND.

.01 In recent years the United States Government has negotiated tar-

iff reductions on a broad range of items with various European nations. One of those items was straight bourbon whiskey, and an agreement was reached whereby the European Economic Community (EEC) would reduce its tariff on importations of such whiskey into its member States (France, Germany, Italy, Belgium, the Netherlands, and Luxemburg) from the U.S. The reduction is being made over a five year period.

.02 The tariff negotiators for the EEC stipulated that there would have to be some means by which member States could be assured that shipments entered at the reduced tariff rate were actually straight bourbon whiskey. By agreement with representatives of the U.S. Government, the EEC entered into its regulations a requirement that to qualify for the reduced tariff, all shipments of such whiskey from the U.S. to a member State would have to be covered by a certificate attesting that the shipment was actually straight bourbon whiskey. This certificate would be prepared by the exporter and verified by a responsible authority of the U.S. Government.

.03 The responsible authority, in this case, is the Alcohol, Tobacco and Firearms Division of the Internal Revenue Service. Working from specifications furnished by representatives of the EEC, through the U.S. Department of State, the Alcohol, Tobacco and Firearms Division has developed a BOURBON WHISKEY—Certificate of Authenticity (Form 4547) that meets the requirements of the EEC regulations. Arrangements have been made whereby an Internal Revenue Service Officer may certify, on Form 4547, that a particular shipment is actually straight bourbon whiskey. Under the terms of the EEC regulations, all shipments of straight bourbon whiskey leaving the U.S. or a foreign-trade zone on or after January 1, 1970, and destined for a member State, must be covered by a properly endorsed Form 4547 to qualify for the reduced tariff rate.

SEC. 3. OBTAINING FORMS 4547.

An exporter may obtain blank Forms 4547 by filing a written request, on his letterhead, with the Assistant Regional Commissioner, Alcohol, Tobacco and Firearms, of the Internal Revenue region in which his place of business is located. Such requests should not specify a quantity of blank forms greater than that needed to meet the exporter's estimated requirements for six months.

SEC. 4. PREPARING FORMS 4547.

.01 Exporters desiring the advantage of the reduced tariff will prepare Forms 4547 in duplicate. All items on the form will be completed except "Certificate of authenticity No.", "Clearance note Nr.", "Place and date of issuance", and, of course, the signature of the Internal Revenue Service Officer. Where the entries to be listed in any column are too numerous to fit on one Form 4547 (e.g., the list of package serial numbers and weights), one or more additional Forms 4547 will be prepared. Each such additional form should be complete in itself. All entries will be made in English.

.02 Entries in the columns on the bottom front of the form will be made as follows:

(a) *Number of packages.* Europeans interpret the word "packages" somewhat differently than we do. The information required in this instance is the number of *items* in the shipment (or the number of items described on any particular set of Forms 4547, where more than one set is necessary). For example, if the shipment consisted of two casks and three cases, the proper entry would be five.

(b) *Serial numbers and marks.* The serial numbers of the first and last cases in a series will be shown (e.g., A21730–A21986). The serial numbers of packages (casks, barrels, etc.) will be listed in numerical order. The entry for "marks" will consist of the plant registry number (e.g., DSP–KY–4401). For packages filled in internal revenue bond, the registry number of the producer of the straight bourbon whiskey will be shown; for bottles filled on bonded premises and bottles and packages filled on bottling premises, the registry number of the bottler or packager will be shown.

(c) *Quantity.* For "Casks", the total number of each size package (cask, barrel, etc.) described on Form 4547 will be shown; for "Bottles", the total number of each size bottle described on Form 4547 will be shown.

(d) *Weight.* The gross and net weights of packages will be entered in the appropriate columns, directly across from the corresponding package serial numbers. Both weights will be shown in metric units (one U.S. ounce is equivalent to 28.35 grams, one U.S. pound is equivalent to 0.4536 kilogram). No gross or net weights need be entered for cases or bottles.

(e) *Quantity (Liter).* For each size package (cask, barrel, etc.) and each size bottle, the total number of liters contained in all packages or bottles of that particular size described on Form 4547 will be entered. One U.S. gallon is equivalent to 3.785 liters.

(f) *Observations.* Appropriate entries may be made to indicate any unusual conditions or circumstances in connection with the shipment described on Form 4547.

SEC. 5. FILING FORM 4547 WITH INTERNAL REVENUE SERVICE OFFICER.

.01 Where straight bourbon whiskey is to be exported without payment of tax, both copies of the completed Form 4547 will be forwarded to the assigned officer at the distilled spirits plant from which the spirits are to be withdrawn. The Forms 4547, as well as any transaction forms that may be pertinent to verification of Form 4547, shall be made available to the officer before, or at the same time, Form 206, Withdrawal of Spirits, Specially Denatured Spirits, or Wines for Exportation, is presented for release of the spirits.

.02 Where straight bourbon whiskey is to be exported with benefit of drawback, both copies of the completed Form 4547, together with a copy of the related Form 1582, Drawback On Distilled Spirits Exported, will be forwarded to the assigned officer at the distilled spirits plant where the spirits were bottled or packaged. Copies of

any related transaction forms that would be needed by the officer to verify the Form 4547 shall also be made available to him. The spirits shall be kept available for inspection at the exporter's premises until the Forms 4547 have been endorsed by the assigned officer (or returned without endorsement because he could not verify that the spirits were actually straight bourbon whiskey).

SEC. 6. ACTION BY INTERNAL REVENUE SERVICE OFFICERS.

.01 The assigned officer will verify that the spirits described on Form 4547 are actually straight bourbon whiskey, enter the place and date of issuance and his signature on both copies of the form, and forward them to his Assistant Regional Commissioner, Alcohol, Tobacco and Firearms.

.02 The Assistant Regional Commissioner will enter a serial number on both copies of Form 4547 (where it has been necessary to use more than one set of Forms 4547 to describe a particular shipment, a different serial number will be assigned to each set), retain the duplicate copy for his files, and return the original to the exporter.

SEC. 7. ACTION BY EXPORTER.

.01 Before forwarding the original of Form 4547 abroad, the exporter will enter the "Clearance note Nr." in the appropriate space on the front of the form. This number will be the "FILE NO." entered by U.S. Customs on U.S. Department of Commerce Form 7525–V, Shipper's Export Declaration.

.02 The EEC regulations provide that the completed Form 4547 will be presented to the Customs authorities of the importing member State within three months after the date of delivery of the merchandise to which it pertains. They further require that the supporting invoices of one or more import declarations will bear the serial number or numbers of the corresponding Forms 4547.

SEC. 8. USE OF FORM 4547 FOR EXPORTS TO OTHER COUNTRIES.

In the event that exporters find that countries other than member States of the EEC require certification as to the authenticity of straight bourbon whiskey, Form 4547 may be used for this purpose if acceptable to the foreign countries involved. Such usage shall be in accordance with the provisions of this Revenue Procedure, except that Section 7.02 will not be applicable.

SEC. 9. INQUIRIES.

Inquiries regarding this Revenue Procedure should refer to its number and be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol, Tobacco and Firearms.

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part 1, Sections 167, 446; 1.167 (e)–1, 1.446–1.)

The Commissioner's consent to a change in method of depreciation accounting from item accounts to multiple asset accounts, or vice versa, may be expeditiously obtained by filing an application with the appropriate district director; Revenue Procedure 67–40 amplified.

Rev. Proc. 69–29

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to amplify Revenue Procedure 67–40, C.B. 1967–2, 674, by extending its application to certain changes in method of accounting for depreciation that have not been covered by that Revenue Procedure. These additional changes in method of accounting are limited to changes from item accounts to any type of multiple asset accounts described in section 1.167(a)–7 of the Income Tax Regulations, or from multiple asset accounts to item accounts.

SEC. 2. BACKGROUND.

.01 Revenue Procedure 67–40 provides an administrative procedure whereby taxpayers may expeditiously obtain consent to change their methods of accounting for depreciation to certain other methods for Federal income tax purposes. Taxpayers complying with the provisions of Revenue Procedure 67–40 are deemed to have obtained the consent of the Commissioner of Internal Revenue to change their method of depreciation accounting.

.02 A change in item accounting for specific assets to multiple asset accounting for the same assets or vice versa is a change in method of accounting for depreciation requiring the consent of the Commissioner. See section 446 of the Internal Revenue Code of 1954 and the regulations thereunder.

.03 The annual regrouping of a taxpayer's assets solely for purposes of facilitating the comparison of the class lives with the guideline lives and applying the reserve ratio test under Revenue Procedure 62–21, C.B. 1962–2, 418, is not a change in method of accounting. (See answer to question 15 in Revenue Procedure 62–21.) However, the consolidation of a taxpayer's assets on a permanent basis into accounts corresponding to guideline classes to compute the amount of allowable depreciation, the class life, and the rate of growth under Revenue Procedure 62–21 is a change in method requiring the consent of the Commissioner.

SEC. 3. CHANGE IN METHOD COVERED BY THIS REVENUE PROCEDURE.

.01 Section 4.01 of Revenue Procedure 67–40 sets out in subsections (a) through (i) those changes in methods covered by the procedures contained in that document for expeditiously accomplishing a change in method of accounting by filing an application on Form 3115, Application for Change in Accounting Method, with the District Director of Internal Revenue who has jurisdiction over the taxpayer's return containing such change.

.02 The provisions of Revenue Procedure 67–40 are hereby extended to any change in method of accounting for assets from item accounts to multiple asset accounts or from multiple asset accounts to item accounts.

.03 Any such change in method of accounting for depreciable assets is subject to all the provisions of Revenue Procedure 67–40.

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SEC. 4. EFFECTIVE DATE.

This Revenue Procedure is effective for taxable years beginning on or after December 15, 1969, the date of its publication in the Internal Revenue Bulletin.

SEC. 5. EFFECT ON OTHER DOCUMENTS.

Revenue Procedure 67–40 is amplified.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 401, 501; 1.401–1, 1.501(a)–1.)

Procedures are provided for the issuance of opinion letters by the National Office on the acceptability of the form of master or prototype pension and profit-sharing plans that include self-employed individuals and the exempt status of related trusts or custodial accounts; Revenue Procedures 69–5 and 69–24 superseded.

Rev. Proc. 69–30

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth the procedures for the issuance of opinion letters by the National Office of the Internal Revenue Service as to the acceptability of the form of any master or prototype plan designed to include groups of self-employed individuals who may adopt such plan.

SEC. 2. BACKGROUND AND GENERAL INFORMATION.

.01 The Self-Employed Individuals Tax Retirement Act of 1962, Public Law 87–792, C.B. 1962–3, 89, applicable to taxable years beginning after December 31, 1962, provides certain tax benefits in connection with pension and profit-sharing plans that include self-employed individuals and that meet the applicable requirements of section 401 of the Internal Revenue Code of 1954. A related trust or custodial account, if any, is exempt from taxation as provided in section 501(a) of the Code unless exemption is denied under section 502 or 503.

.02 The general procedures of the Service relating to the issuance of rulings and determination letters are set forth in section 601.201 of the Statement of Procedural Rules (Revenue Procedure 69–1, C.B. 1969–1, 381). Section 601.201(o) of the Statement of Procedure Rules (Revenue Procedure 69–4, C.B. 1969–1, 391) provides the procedures relating to the issuance of determination letters as to the qualification of employees' plans or trusts under sections 401(a) and 405(a) of the Code and to the exempt status of related trusts or custodial accounts, if any, under section 501(a) of the Code.

.03 Pursuant to section 601.201(p) of the Statement of Procedural Rules (Revenue Procedure 69–5, C.B. 1969–1, 395) sponsoring organizations have applied to District Directors of Internal Revenue for opinion letters as to the acceptability of the form of such plans. In addition, District Directors have processed requests by self-employed individuals for advance determinations concerning their adoption of master or prototype plans previously approved as to form. However, this latter practice has been discontinued. See Rev. Proc. 69–24, page 306, this Bulletin.

SEC. 3. RULINGS, DETERMINATION LETTERS AND OPINION LETTERS.

.01 The National Office of the Service, upon request, will furnish a written opinion as to the acceptability (for the purpose of sections 401 and 501(a) of the Code) of the form of any master or prototype plan designed to include groups of self-employed individuals who may adopt the plan, where the plan is submitted by a sponsor that is a trade or professional association, bank, insurance company, or regulated investment company as defined in section 851 of the Code. Each opinion letter will bear an identifying plan serial number. If the trustee or custodian has been designated at the time of approval of a plan as to form, a ruling will be issued as to the exempt status of such trust or custodial account which forms part of the master or prototype plan. As used here, the term "master plan" refers to a standardized form of plan, with a related trust or custodial agreement, where indicated, administered by the sponsoring organization for the purpose of providing plan benefits on a standardized basis. The term "prototype plan" refers to a standardized form of plan, with or without a related form of trust or custodial agreement, that is made available by the sponsoring organization, for use without change by employers who wish to adopt such a plan, and which will not be administered by the sponsoring organization that makes such form available. The degree of relationship among the separate employers adopting either a master plan or a prototype plan or to the sponsoring organization is immaterial.

.02 Since a determination as to the qualification of a particular employer's plan can be made only with regard to facts peculiar to that employer, a letter expressing the opinion of the Service as to the acceptability of the form of a master or prototype plan will not constitute a ruling or determination as to the qualification of a plan as adopted by any individual employer or as to the exempt status of a related trust or custodial account. However, where an employer adopts a master or prototype plan and any related prototype trust or custodial account previously approved as to form, and observes the provisions thereof, such plan and trust or custodial account will be deemed to satisfy the requirements of sections 401 and 501(a) of the Code, provided the eligibility requirements and contributions or benefits under the plan for owner-employees are not more favorable than for other employees, including those required to be covered under plans of all businesses controlled by such owner-employees.

.03 Although District Directors no longer make advance determinations on plans of self-employed individuals who have adopted previously approved master or prototype plans, they will continue, upon request, to issue determination letters as to the qualification of individually designed plans (those not utilizing a master or prototype plan) and the exempt status of a related trust or custodial account, if any, in accordance with the procedures set forth in section 601.201(o) of the Statement of Procedural Rules.

SEC. 4. DETERMINATION LETTERS AS TO QUALIFIED BOND PURCHASE PLANS.

A determination as to the qualification of a bond purchase plan will, upon request, be made by the appropriate District Director. Form 4578, Application for Approval of Bond Purchase Plan, must be used for this purpose. When properly completed, that form will constitute a bond purchase plan.

SEC. 5. INSTRUCTIONS TO SPONSORING ORGANIZATIONS AND EMPLOYERS.

.01 A sponsoring organization of the type referred to in section 3.01 above, that desires a written opinion as to the acceptability of the form of a master or prototype plan (or as to the exempt status of a related trust or custodial account) should submit its request to the National Office. Copies of all documents, including the plan and trust instruments and all amendments thereto, together with specimen insurance contracts (where applicable) must be submitted with the request. The request must be submitted to the Commissioner of Internal Revenue Service, Washington, D.C. 20224, Attn: T: MS: PT. Form 3672, Application for Approval of Master or Protoype Plan for Self-Employed Individuals, is to be used for this purpose.

.02 If, subsequent to obtaining approval of the form of a master or prototype plan, an amendment is to be made, the procedure will depend on whether the sponsor is authorized to act on behalf of the subscribers.

1 If the plan provides that each employer has delegated to the sponsor the power to amend the plan and that each employer shall be deemed to have consented thereto, the plan may be amended by the sponsor. If the plan contains no specific provision permitting the sponsor to amend such plan, but all employers consent in writing to permit such amendment, the sponsor may then amend the plan. However, where a sponsor is unable to secure the consent of each employer, the plan cannot be amended by the sponsor. In such cases, any change will have to be effected by the adoption of a new plan and the submission of a new Form 3672. The new plan will be complete and separate from the old plan and individual employers may, if they desire, substitute the new plan for the old plan.

2 In the first two instances mentioned above, where the plan has been properly amended, the sponsor must submit Form 3672, a copy of the amendment and, if required, copies of the signed consent of each participating employer.

3 Upon approval of the amendment by the Service, an opinion letter will be issued to the sponsor containing the serial number of the original plan, followed by a suffix: "A–1" for the first amendment, "A–2" for the second amendment, etc. Employers adopting the form of plan subsequent to the date of the amendment will use the revised serial number.

4 If a new plan is submitted, together with Form 3672 and copies of all documents evidencing the plan, an opinion letter bearing a new serial number will be issued to the sponsor and all employers who adopt the new plan shall use the new serial number. Employers who adopted the old plan will continue to use the original serial number.

SEC. 6. EFFECT ON OTHER DOCUMENTS.

.01 The general procedures of section 601.201 of the Statement of Procedural Rules (Revenue Procedure 69–1 and Revenue Procedure 69–4), relating to the issuance of rulings and determination letters, are applicable to requests relating to the qualification of plans covering self-employed individuals under sections 401 and 405(a) of the Code and the exempt status of related trusts or custodial accounts under section 501(a), to the extent that the matter is not covered by the specific procedures and instructions contained in this Revenue Procedure.

.02 Revenue Procedure 69–5 and Revenue Procedure 69–24 are hereby superseded.

SEC. 7. EFFECTIVE DATE.

This Revenue Procedure is effective December 22, 1969, the date of its publication in the Internal Revenue Bulletin.

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 April 12, 1969 (34 F.R. 6424) [C.B. 1969–1, 455]. The following amendments are made to Part 601:

PARAGRAPH 1. Section 601.106 is amended by revising paragraph (a)(1), (b), and (f)(5) to 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 requests Appellate consideration and submits a written protest, when required, to the determination of liability made by that officer. A written protest is required if the total amount of proposed additional tax, proposed additions to tax and penalties, proposed overassess-

[1] 34 F.R. 14600.

ment, or claimed refund (or in an offer in compromise, the total amount of unpaid tax, additions to tax, penalties, and assessed interest sought to be compromised) exceeds $2,500 for any taxable period. A written protest is also required if no district conference is held regardless of the amount involved. 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. If the statutory notice of deficiency was issued by a district director or the Director of International Operations, the Appellate Division may waive jurisdiction to the director who issued the statutory notice during the 90-day (or 150-day) period for filing petition with the Tax Court, except where criminal prosecution has been recommended and not finally disposed of or the statutory notice includes the ad valorem fraud penalty. 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.

* * * * *

(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 requests Appellate consideration and files a written protest when required (see paragraph (c)(1) of §§ 601.103 and 601.507) 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. However, the appeal procedures do not extend to cases involving solely the failure or refusal to comply with the tax laws because of moral, religious, political, constitutional, conscientious, or similar grounds. 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 or legislation, political campaigns, or propaganda related to those purposes are treated as "taxpayers" for the purpose of this right of administrative appeal. Thus, upon requesting Appellate consideration and filing a written protest, when required, to the district director's findings that a portion of member dues is to disallowed as a deduction to each member because expended for such purposes, the organization will be afforded full rights of administrative appeal to the Appelate Division of the region similar to those rights afforded to taxpayers generally. After review of any required written 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.

* * * * *

(f) *Conference and practice requirements.* * * *

(5) *Rule V.* In order to bring an unagreed income, estate, or gift tax case in prestatutory notice status, an unagreed employment or excise tax case, or an offer in compromise before the Appellate Division, the taxpayer or his representative should first file with the district office, Service Center, or Office of International Operations a written protest setting forth specifically the reasons for his refusal to accept the findings. If the protest includes a statement of facts upon which the taxpayer relies, such statement should be declared to be true under the penalties of perjury. The protest and any new facts, law, or arguments presented therewith will be reviewed by the receiving office 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 it may, with the concurrence of the taxpayer, assume jurisdiction in a related case, after the office having original jurisdiction has completed any necessary action. The Director, Appellate Division, may authorize the regional Appellate Divisions to accept jurisdiction (after any necessary action by office having original jurisdiction) in specified classes of cases without written protests provided written or oral requests for Appellate Division consideration are submitted by or for each taxpayer.

* * * * *

PAR. 2. Section 601.201 is amended by revising paragraphs (c)(4) and (d)(3), and by revising subparagraphs (6)(iii) and (12) of paragraph (e). These revised provisions read as follows:

§ 601.201 Rulings and determination letters.

* * * * *

(c) *Determination letters issued by district directors.* * * *

(4) Notwithstanding the provisions of subparagraphs (1), (2), (3), (5), and (6) of this paragraph, a district director will not issue a determination letter in response to an inquiry, although the inquiry presents a question specifically covered 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 involving the same taxpayer 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 provisions of subparagraph (3) of this paragraph, a district director will not issue a determination letter on an employment tax question when the specific question involved has been considered or is being considered by the Central Office of the Social Security Administration. Nor will district directors issue determination letters on excise tax questions if a request is for a determination of a constructive sales price under section 4216(b) or 4218(e) of the Code. However, the National Office will issue rulings in this area. See paragraph (d) (3) of this section.

* * * * *

(d) *Discretionary authority to issue rulings and determination letters.** * *

(3) The National Office will issue rulings in all cases on prospective or future transactions when the law or regulations require a determination of the effect of a proposed transaction for tax purposes, as in the case of a transfer coming within the provisions of sections 1491 and 1492 of the Code, or an exchange coming within the provisions of section 367 of the Code. The National Office will issue rulings in all cases involving the determination of a constructive sales price under section 4216(b) or 4218(e) of the Code.

* * * * *

(e) *Instructions to taxpayers.* * * *

(6) * * *

(iii) A person, other than an attorney or certified public accountant, enrolled to practice before the Service, and who files with the Service a written declaration that he is currently enrolled (including in the declaration either his enrollment number or the expiration date of his enrollment card) and that he is authorized to represent the principal. (See Treasury Department Circular No. 230, as amended, C.B. 1966–2, 1171, for the rules on who may practice before the Service. See § 601.503(c) for the statement required as evidence of recognition as an enrollee.)

* * * * *

(12) Where a taxpayer has received an adverse determination under section 367 of the Code, a protest directed to the position upon which the adverse determination is based will be considered by an informal board established for this purpose by the Assistant Commissioner (Technical). All protests, whether or not there is a conference, will be considered by the board and the board will notify the Income Tax Division of its decision. The taxpayer will be notified by the Income Tax Division of the results of the board's consideration of the protest. This procedure is invoked by a request directed to the Assistant Commissioner (Technical).

* * * * *

PAR. 3. Section 601.202 is amended by revising paragraphs (b) and (c) (6) to read as follows:

§ 601.202 Closing agreements.

* * * * *

(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 generally 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 and entered into at any time before the determination of such liability becomes a matter within the province of a court of competent jurisdiction and may thereafter be entered into in appropriate circumstances when authorized by the court (e.g., in certain bankruptcy situations). 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) *Approval.* * * *

(6) Closing agreements providing for the mitigation of economic double taxation under section 3 of Revenue Procedure 64–54, C.B. 1964–2, 1008, or under Revenue Procedure 69–13, C.B. 1969–1, 402, or for such mitigation and relief under Revenue Procedure 65–17, C.B. 1965–1, 833, may be entered into and approved by the Director of International Operations. The Director of International Operations may also enter into and approve closing agreements for a taxable period or periods ended prior to the date of agreement and related specific items affecting other taxable periods, as the competent authority in the administration of the operating provisions of the tax conventions of the United States.

* * * * *

PAR. 4. Section 601.203 is amended by revising paragraph (d) to read as follows:

§ 601.203 Offers in compromise.

* * * * *

(d) *Conferences.* Before filing a formal offer in compromise, a taxpayer

may request a meeting in the office which would have jurisdiction over his offer to explore the possibilities of compromising unpaid tax liability. After all investigations have been made, the taxpayer may also request a meeting in the office having jurisdiction of his offer to determine the amount which may be accepted as a compromise. If agreement is not reached at such meeting and the district director has processing jurisdiction over the offer, the taxpayer will be informed that he may request a district conference. A written protest is required if the assessed tax, penalty, and interest exceeds $2,500 for any return or taxable period. If agreement is not reached at the district conference, the taxpayer will be offered an opportunity to request consideration of his case by the regional office of the Appellate Division. Such request may be in writing or oral. If the assessed tax, penalty, and interest exceeds $2,500 for any return or taxable period, a written protest is required. The procedure in the three preceding sentences does not apply if the offer relates to a tax over which Appellate Division has no authority (see § 601.106(a)(3)). Taxpayers and their representatives are required to fulfill and comply with the applicable conference and practice requirements. See Subpart E of this part.

PAR. 5. The following new section is added immediately after section 601.205:

§ 601.206 Certification required to obtain reduced foreign tax rates under income tax treaties.

(a) *Basis of certification.* Most of the income tax treaties between the United States and foreign countries provide for either a reduction in the statutory rate of tax or an exemption from tax on certain types of income received from sources within the foreign treaty country by citizens, domestic corporations, and residents of the United States. Some of the treaty countries reduce the withholding tax on such types of income or exempt the income from withholding tax after the claimant furnishes evidence that he is entitled to the benefits of the treaty. Other countries initially withhold the tax at statutory rates and refund the excess tax withheld after satisfactory evidence of United States residence has been accepted. As part of the proof that the applicant is a resident of the United States and thus entitled to the benefits of the treaty, he must usually furnish a certification from the United States Government that he has filed a U.S. income tax return as a citizen, domestic corporation, or resident of the United States.

(b) *Procedure for obtaining the certification.* Most of the treaty countries which require certification have printed special forms. The forms contain a series of questions to be answered by the taxpayer claiming the benefits of the treaty, followed by a statement which the foreign governments use for the U.S. taxing authority's certification. This certification may be obtained from the office of the district director of the district in which the claimant filed his latest income tax return. Some certification forms are acceptable for Service execution; however, others cannot be executed by the Service without revision. In these instances the office of the district director will prepare its own document of certification in accordance with internal instructions. This procedure has been accepted by most treaty countries as a satisfactory substitute.

(c) *Obtaining the official certification forms.* The forms may be obtained from the foreign payor, the tax authority of the treaty country involved, or the Office of International Operations.

PAR. 6. Section 601.301 is amended by revising paragraph (c) to 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, Tobacco, and Firearms 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 the contents of applications, notices, registrations, permits, bonds, and other documents. Supplies of prescribed forms may be obtained from the office of assistant regional commissioners (alcohol, tobacco, and firearms), except that Forms 52–A, 52–B, 122, 133, 338, 2051, 2056–2060, 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. IRS Publication No. 480, which contains a listing of alcohol, tobacco, and firearms public-use forms, may be purchased from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402. Such publication is available, for reference purposes, in Internal Revenue Service reading rooms. The following is a brief description of the several regulations arranged according to the principal subjects and operations concerned:

* * * * *

PAR. 7. Section 601.303 is amended by revising paragraphs (d) and (e) to read as follows:

§ 601.303 Claims.

* * * * *

(d) *Claims for allowance, credit, or relief.* A qualified permittee, manufacturer, or proprietor may, subject to the conditions in the appropriate regulations, file claim on Form 2635 with the assistant regional commissioner (alcohol, tobacco, and firearms) for allowance of loss, credit of tax, or relief from tax liability, as applicable, on (1) spirits returned to bonded premises, lost or destroyed on bonded premises or in transit thereto, lost in rectification or bottling operations, or lost by accident or disaster; (2) wine lost or destroyed on bonded premises or in transit thereto, and unmerchantable domestic wine returned to bond; (3) beer removed from the market, lost (other

than by theft), or destroyed by fire, casualty, or act of God; (4) denatured spirits lost or destroyed in bond, or lost on the premises of a qualified dealer or user or in transit to such premises; and (5) tax-free spirits lost on the premises of a qualified user or in transit to such premises.

(e) *Claims for payment—disaster losses.* When distilled spirits, wines, rectified products, or beer held or intended for sale is 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, the person holding such product for sale at that time may, subject to the conditions in the appropriate regulations, file claim on Form 843 with the assistant regional commissioner (alcohol, tobacco, and firearms) of the region in which the product was lost, rendered unmarketable, or condemned, for payment of an amount equal to the internal revenue taxes paid or determined and any customs duties paid thereon. Claims must be filed within 6 months from the date on which the President makes the determination that the disaster has occurred. The determination date is construed to mean the date the Director, Office of Emergency Preparedness, identifies the specific disaster area.

PAR. 8. Section 601.315 is amended by revising paragraph (f) to read as follows:

§ 601.315 Claims.

* * * * *

(f) *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 are 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. Claims must be filed within 6 months from the date on which the President makes the determination that the disaster has occurred. The determination date is construed to mean the date the Director, Office of Emergency Preparedness, identifies the specific disaster area.

* * * * *

PAR. 9. Section 601.318 is revised to read as follows:

§ 601.318 Forms.

Detailed information as to all forms prescribed for use in connection with tobacco taxes is contained in the regulations referred to in § 601.311(b). Copies of all necessary forms, and instructions as to their preparation and filing, may be obtained from assistant regional commissioners (alcohol, tobacco, and firearms). IRS Publication No. 480, which contains a listing of alcohol, tobacco, and firearms public-use forms, may be purchased from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402. Such publication is available, for reference purposes, in Internal Revenue Service reading rooms.

PAR. 10. Section 601.319 is revised to read as follows:

§ 601.319 Applicable laws.

Chapter 53 of the Internal Revenue Code (26 U.S.C. 5801–5872), the provisions of which are chiefly derived from the National Firearms Act amendments of 1968 (82 Stat. 1227), imposes a tax on the manufacture and transfer in the United States, of machine guns, destructive devices, and certain other types of firearms, and an occupational tax upon every importer and manufacturer of, and dealer in, such 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 and forfeiture of vessels, vehicles, and aircraft which are used to transport, carry, or possess, or to facilitate the same, any firearm with respect to which there has been committed any violation of the National Firearms Act or any regulations issued pursuant thereto. Title 1, State Firearms Control Assistance (18 U.S.C., chapter 44), of the Gun Control Act of 1968 (82 Stat. 1213) [P.L. 90–618, C.B. 1968–2, 749], provides for the licensing of importers and manufacturers of, and dealers in, firearms and ammunition, and of collectors of firearms and ammunition curios and relics, and establishes controls for firearms and ammunition acquisitions and dispositions. Title VII, Unlawful Possession or Receipt of Firearms (82 Stat. 236; 18 U.S.C., Appendix), of the Omnibus Crime Control and Safe Streets Act of 1968 (82 Stat. 197) [P.L. 90–351, C.B. 1968–2, 711], as amended by Title III of the Gun Control Act of 1968 (82 Stat. 1236), prohibits the receipt, possession, or transportation of firearms by felons (as that term is defined in that Title), veterans who are discharged under dishonorable conditions, mental incompetents, aliens who are illegally in the country, and former citizens of the United States who have renounced such citizenship; and also prohibits the same by any employee of such persons in the course of his employment.

PAR. 11. Section 601.320 is revised to read as follows:

§ 601.320 Taxes relating to machine guns, destructive devices, and certain other firearms.

Part 179 of this chapter contains the regulations relative to the (a) payment of special (occupational) taxes by manufacturers and importers of, and dealers in, machine guns, destructive devices, and certain other types of firearms, (b) payment of the tax on the making or transfer of such firearms, (c) registration, identification, importation and exportation of such firearms, (d) keeping of books and records and rendering of returns, and (e) the forfeiture and disposition of seized firearms under the provisions of the National Firearms Act.

PAR. 12. Section 601.321 is revised to read as follows:

§ 601.321 Commerce in firearms and ammunition.

Part 178 of this chapter contains the regulations relative to (a) the licensing of importers and manufacturers of, and dealers in, firearms and ammunition,

and collectors of firearms and ammunition curios and relics, (b) the identification of firearms, (c) the acquistion and disposition of firearms and ammunition, (d) the records required to be kept by licensees, and (e) the forfeiture and disposition of seized firearms and ammunition, under the provisions of Title 1 of the Gun Control Act of 1968, and also (f) the restrictions regarding the receipt, possession, or transportation of firearms by certain persons under the provisions of Title VII of the Omnibus Crime Control and Safe Streets Act of 1968, as amended.

PAR. 13. Section 601.323 is revised to read as follows:

§ 601.323 Assessments.

Where the evidence disclosed by investigation establishes that additional or delinquent tax liability has been incurred and not paid, the assistant regional commissioner (alcohol, tobacco, and firearms), will notify the director of the service center to list the tax as an assessment. Notification and demand for payment of assessed taxes will be issued the taxpayer by the director of the service center.

PAR. 14. Section 601.324 is amended by revising paragraphs (a), (b), and (c) to read as follows:

§ 601.324 Claims.

* * * * *

(a) Claims for refund of the making and transfer taxes, and of occupational taxes, whether assessed or voluntarily paid, and claims for redemption of "National Firearms Act" stamps, are prepared and filed in accordance with the procedures set forth in Part 179 of this chapter.

(b) Claims for abatement of making and transfer taxes are prepared and filed in accordance with the procedures set forth in § 601.303(b).

(c) Claims for abatement of occupational taxes and penalties erroneously assessed, and claims for redemption of stamps for occupational taxes, are prepared and filed in accordance with the procedures set forth in § 601.304(h).

* * * * *

PAR. 15. Section 601.326 is revised to read as follows:

§ 601.326 Seizure and forfeiture of personal property.

Part 172 of this chapter contains the regulations relative to the personal property seized by officers of the Internal Revenue Service as subject to forfeiture as being used, or intended to be used, to violate certain Federal laws; the remission or mitigation of such forfeiture; and the administrative sale or other disposition, pursuant to forfeiture, of such seized property other than firearms seized under the National Firearms Act and firearms and ammunition seized under Title 1 of the Gun Control Act of 1968. For disposal of firearms under the National Firearms Act, see 26 U.S.C. 5872(b). For disposal of firearms and ammunition under Title 1 of the Gun Control Act of 1968, see 18 U.S.C. 924(d).

PAR. 16. Section 601.327 is amended by revising paragraph (c) to read as follows:

§ 601.327 Offers in compromise.

* * * * *

(c) *Forfeiture liabilities.* The assistant regional commissioner (alcohol, tobacco, and firearms) is authorized to compromise liabilities to administrative forfeiture of personal property seized under the laws administered and enforced by the Internal Revenue Service, including liabilities to forfeiture under 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 chief special investigator (alcohol, tobacco, and firearms). Such offers are forwarded to the assistant regional commissioner (alcohol, tobacco, and firearms) for final action. When the offer is acted upon, the proponent is 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. 17. Section 601.328 is amended by revising paragraph (a) to read as follows:

§ 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, destructive devices, 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 importers and manufacturers of, and dealers in, firearms and ammunition, and collectors of firearms and ammunition curios and relics, under chapter 44 of Title 18 of the United States Code, may request a ruling thereon by addressing a letter to the Director, Alcohol, Tobacco, and Firearms Division, Internal Revenue Service, Washington, D.C. 20224, or to the assistant regional commissioner (alcohol, tobacco, and firearms) 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, Tobacco, and Firearms 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. If a request for a ruling is signed by a representative, or if the representative is to appear before the Internal Revenue Service, such representative must present a tax information authorization or a power of attorney, signed by the taxpayer, authorizing him to receive or inspect confidential information in the matter (see Subpart E of this part).

* * * * *

PAR. 18. Section 601.501 is amended by revising paragraph (a) to read as follows:

§ 601.501 Scope of conference and practice requirements; definitions.

(a) *Scope.* The conference and practice requirements prescribed in this subpart apply to all offices of the Internal Revenue Service, including the Office of the Chief Counsel. Such requirements are applicable to practice (including conferences) with respect to any matter involving any internal revenue tax, but do not extend to the mere signing of a tax return, claim, or election, since such an act, of itself, does not constitute practice before the Revenue Service. The signing of a tax return, claim, or election is governed by other rules or instructions relating to such matters. For special provisions relating to alcohol, tobacco, and firearms activities, see §§ 601.521 through 601.527.

* * * * *

PAR. 19. The center heading preceding § 601.521 is revised to read as follows:

"Requirements for Alcohol, Tobacco, and Firearms Activities"

PAR. 20. Section 601.522 is revised to read as follows:

§ 601.522 Power of attorney.

Except as otherwise provided in this section, a power of attorney, or copy thereof, will be required for a representative of a principal (a) to perform the acts specified in paragraph (c) (1) of § 601.502; or (b) to sign any application, bond, notice, return, report, or other document required by, or provided for in, regulations issued pursuant to chapter 51 (Distilled Spirits, Wines, and Beer), chapter 52 (Cigars, Cigarettes, and Cigarette Papers and Tubes), and chapter 53 (Machine Guns, Destructive Devices, and Certain Other Firearms), Internal Revenue Code, Title 1 of the Gun Control Act of 1968, or the Federal Alcohol Administration Act, which is filed with or acted on by (1) the office of an assistant regional commissioner (alcohol, tobacco, and firearms), or (2) the Director, Alcohol, Tobacco, and Firearms Division. The power of attorney may be executed on Form 1534, copies of which may be obtained from the assistant regional commissioner (alcohol, tobacco, and firearms). A power of attorney will not be required for a person authorized to sign on behalf of the principal by articles of incorporation, bylaws, or a board of directors, where an acceptable copy of such authorization is on file in the office of the assistant regional commissioner or of the Director. A power of attorney filed under the provisions of this section may cover one or more acts for which a power of attorney is required and will continue in effect with respect to such acts until revoked as provided in § 601.526. The exceptions to the requirements for a power of attorney contained in paragraph (c) (3) and (4) of § 601.502 are applicable to powers of attorney under this section.

PAR. 21. The section heading to § 601.527 is revised to read as follows:

§ 601.527 Other provisions applied to representation in alcohol, tobacco, and firearms activities.

PAR. 22. Section 601.702 is amended by revising so much of paragraph (a) (1) as follows subdivision (v) and so much of paragraph (d) (8) (ii) as precedes (*b*) thereof. These revised provisions read as follows:

§ 601.702 Publication and public inspection.

(a) *Publication in the Federal Register*—(1) *Requirement.* * * * Pursuant to the foregoing requirements, the Commissioner publishes in the Federal Register from time to time a statement, which is not codified in this chapter, on the organization and functions of the Internal Revenue Service, and such amendments as are needed to keep the statement on a current basis. In addition, there are published in the Federal Register the rules set forth in this part (Statement of Procedural Rules), such as those in subpart E, relating to conference and practice requirements of the Internal Revenue Service; the regulations in Part 178 of this chapter (Commerce in Firearms and Ammunition); the regulations in Part 200 of this chapter (Rules of Practice in Permit Proceedings); the regulations in Part 301 of this chapter (Procedure and Administration Regulations); the various substantive regulations under the Internal Revenue Code of 1954, such as the regulations in Part 1 of this chapter (Income Tax Regulations), in Part 20 of this chapter (Estate Tax Regulations), in Part 31 of this chapter (Employment Tax Regulations), in Part 47 of this chapter (Documentary Stamp Tax Regulations), or Part 201 of this chapter (Distilled Spirits Plants Regulations); the substantive regulations under the Federal Alcohol Administration Act (49 Stat. 977, as amended, 27 U.S.C. 201 et seq.), such as 27 CFR Part 1 (Basic Permit Regulations), 27 CFR Part 4 (Wine Labeling and Advertising Regulations), or 27 CFR Part 5 (Distilled Spirits Labeling and Advertising Regulations); and, whenever the Commissioner grants relief to any person pursuant to Part 178 of this chapter (Commerce in Firearms and Ammunition), the notice of such action together with the reasons therefor.

* * * * *

(d) *Rules for disclosure of certain specified matters.** * *

(8) *Accepted offers in compromise.* * * *

(ii) *Alcohol and tobacco.* For each offer in compromise submitted and accepted pursuant to section 7122 in any case arising under subtitle E of the Code (relating to alcohol, tobacco, and certain other excise taxes); pursuant to section 7 of the Federal Alcohol Administration Act (27 U.S.C. 207) in any case arising under that Act; or in connection with property seized under Title 1 of the Gun Control Act of 1968 (18 U.S.C., chapter 44), a copy of the Abstract and Statement relating to the offer will be available for public inspection, for a period of 1 year from the date of acceptance, in—

(*a*) The office of the assistant regional commissioner (alcohol, tobacco, and firearms) who received the offer

and in the office of the district director for the internal revenue district in which the offer was submitted, in the case of offers accepted pursuant to the Code or Title 1 of the Gun Control Act of 1968, or

* * * * *

[SEAL]

RANDOLPH W. THROWER,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on Sept. 18, 1969, 8:49 a.m., and published in the issue of the Federal Register for Sept. 19, 1969, 34 F.R. 14600)

Treasury Department Order No. 107 (Revision No. 12)

Authority to Affix Seal of the Treasury Department

By virtue of the authority vested in the Secretary of the Treasury, including the authority conferred by 5 U.S.C. 301, and by virtue of the authority delegated to me by Treasury Department Order No. 190 (Revised), it is hereby ordered that:

1. Except as provided in paragraph 2, the following officers are authorized to affix the Seal of the Treasury Department in the authentication of originals and copies of books, records, papers, writings, and documents of the Department, for all purposes, including the purposes authorized by 28 U.S.C. 1733(b):

(a) In the Office of Administrative Services:

(1) Director of Administrative Services

(2) Chief, General Services Division

(3) Chief, Printing and Procurement Division

(4) Chief, Directives Control and Distribution Branch

(b) In the Internal Revenue Service:

(1) Commissioner of Internal Revenue

(2) Director, and Assistant Director, Collection Division

(3) Chief, and Assistant Chief, Disclosure and Liaison Branch, Collection Division

(4) Director, Assistant Director and Technical Advisor, Alcohol, Tobacco and Firearms Division

(5) Chief, and Assistant Chief, Enforcement Branch, Alcohol, Tobacco and Firearms Division

(6) Chief, and Assistant Chief, Operations-Coordination Section, Enforcement Branch, Alcohol, Tobacco and Firearms Division

(c) In the Bureau of Customs:

(1) Commissioner of Customs

(2) Deputy Commissioner of Customs

(3) Assistant Commissioner of Customs (Administration)

(4) Assistant Commissioner of Customs (Investigations)

(5) Assistant Commissioner of Customs (Operations)

(6) Assistant Commissioner of Customs (Regulations and Rulings)

(d) In the Bureau of the Public Debt:

(1) Commissioner of the Public Debt

(2) Deputy Commissioner in Charge of the Chicago Office

(3) Assistant Deputy Commissioner in Charge of the Chicago Office

2. Copies of documents which are to be published in the Federal Register may be certified only by the officers named in paragraph 1(a) of this Order.

3. The Director of Administrative Services, the Commissioner of Internal Revenue Service, and the Commissioner of the Public Debt are authorized to procure and maintain custody of the dies of the Treasury Seal.

The officers authorized in paragraph 1 (c) may make use of such dies.

A. E. WEATHERBEE,
Assistant Secretary for Administration.

Dated: June 16, 1969.

(Filed by the Office of the Federal Register on June 20, 1969, 8:50 A.M., and published in the issue of the Federal Register for June 21, 1969, 34 F.R. 9721)

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The abbreviation and number in parentheses following the index entry refer to the specific item; numbers in italic type following the parentheses refer to the page number on which it appears.

Key to Abbreviations:

RR	Revenue Ruling	EO	Executive Order
RP	Revenue Procedure	DO	Delegation Order
TD	Treasury Decision	TDO	Treasury Department Order
CD	Court Decision	TC	Tax Convention
PL	Public Law	SPR	Statement of Procedural Rules

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