TREASURY DEPARTMENT

UNITED STATES INTERNAL REVENUE

REGULATIONS 45

(1920 EDITION)

RELATING TO THE

INCOME TAX

AND

WAR PROFITS AND EXCESS PROFITS TAX

UNDER THE

REVENUE ACT OF 1918

PROMULGATED JANUARY 28, 1921

WASHINGTON
GOVERNMENT PRINTING OFFICE
1921

INCOME TAX BULLETIN SERVICE.

The Income Tax Bulletin Service for 1921, consisting of weekly Bulletins of income tax rulings, bimonthly Digests of rulings published in the weekly bulletins, and semiannual Cumulative Bulletins containing in full the rulings in the weekly bulletins published during the previous six months may be obtained by subscription for $2.

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[40 U. S. Statutes at Large, 1057.]

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PART I.

INCOME TAX ON INDIVIDUALS.

NORMAL TAX.

SEC. 210. That, in lieu of the taxes imposed by subdivision (a) of section 1 of the Revenue Act of 1916 and by section 1 of the Revenue Act of 1917, there shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax at the following rates:

(a) For the calendar year 1918, 12 per centum of the amount of the net income in excess of the credits provided in section 216: *Provided*, That in the case of a citizen or resident of the United States the rate upon the first $4,000 of such excess amount shall be 6 per centum;

(b) For each calendar year thereafter, 8 per centum of the amount of the net income in excess of the credits provided in section 216: *Provided*, That in the case of a citizen or resident of the United States the rate upon the first $4,000 of such excess amount shall be 4 per centum.

ARTICLE 1. **Income tax on individuals.**—The statute imposes an income tax on individuals, including a normal tax and a surtax. See section 211 of the statute. The tax is upon net income, as defined in the statute, after deducting from gross income, as defined in the statute, the allowable deductions. See sections 212, 213, 214, and 215. In certain cases credits are allowed against net income and against the amount of the tax. See sections 216 and 222. Special provisions of the statute deal with the effect of the tax on nonresident alien individuals, partnerships, and personal service corporations, estates and trusts, and the stockholders of corporations which unreasonably accumulate their profits. See sections 217, 218, 219, and 220. The tax is payable upon the basis of returns rendered by the persons liable thereto, except that in some instances it is to be paid at the source of the income. See sections 221, 223, 224, 225, 226, 227, and 228. The statute also imposes an income tax at a fixed rate and a war profits and excess profits tax on corporations. See Part II of the regulations. For administrative provisions, and for definitions and general provisions, see Parts III and IV of the regulations.

ART. 2. **Normal tax.**—For the calendar year 1918 the normal income tax on individual citizens or residents of the United States is at the rate of 6 per cent upon the first $4,000 of net income subject to the normal tax and 12 per cent upon the excess over that amount, and for the calendar year 1919 and subsequent years is at the rate of 4 per cent upon the first $4,000 and 8 per cent upon the excess over that amount. The lower rate on the first $4,000 applies to each separate individual, whether married or unmarried, and should not be confused with the joint exemption granted married persons. In the case of nonresident alien individuals the normal tax for 1918 is 12 per cent and for subsequent years 8 per cent. In order to determine the income to which the normal tax is applied, the net income, as defined in section 212 of the statute and articles 21–26 of the regulations, is first entitled to the credits and exemptions specified in section 216 of the statute and articles 301–307.

ART. 3. **Persons liable to tax.**—Every citizen of the United States, wherever resident, is liable to the tax. It makes no difference that he may own no assets within the United States and may receive no income from sources within the United States. Every resident alien individual is liable to the tax, even though his income is wholly from sources outside the United States. Every nonresident alien individual is liable to the tax on his income from sources within the United States. See section 213(c) and articles 91–93. Estates and trusts are also subject to the tax. See section 219 and articles 341–347.

ART. 4. **Who is a citizen.**—Every person born in the United States subject to its jurisdiction, or naturalized in the United States, is a citizen. When any naturalized citizen has left the United States and resided for two years in the foreign country from which he came, or for five years in any other foreign country, it is presumed that he has ceased to be an American citizen; but this presumption does not apply to residence abroad while the United States is at war. For example, a Swede who, after having come to the United States and become naturalized here, returned to Sweden and resided there for two years prior to April 6, 1917, is presumed to be once more an alien. On the other hand, an individual born in the United States subject to its jurisdiction, of either citizen or alien parents, who has long since moved to a foreign country and established a domicile there, but who has never been naturalized in or taken an oath of allegiance to that or any other foreign country, is still a citizen of the United States. A foreigner who has come to the United States and filed his declaration of intention of becoming a citizen, but who has not yet received his final citizenship papers, is an alien. For the distinction between resident alien individuals and nonresident alien individuals see articles 312–315.

SURTAX.

SEC. 211. (a) That, in lieu of the taxes imposed by subdivision (b) of section 1 of the Revenue Act of 1916 and by section 2 of the Revenue Act of 1917, but in addition to the normal tax imposed by section 210 of this Act, there shall be levied, collected, and paid for each taxable year upon the net income of every individual, a surtax equal to the sum of the following:

1 per centum of the amount by which the net income exceeds $5,000 and does not exceed $6,000;

2 per centum of the amount by which the net income exceeds $6,000 and does not exceed $8,000;

3 per centum of the amount by which the net income exceeds $8,000 and does not exceed $10,000;

4 per centum of the amount by which the net income exceeds $10,000 and does not exceed $12,000;

5 per centum of the amount by which the net income exceeds $12,000 and does not exceed $14,000;

6 per centum of the amount by which the net income exceeds $14,000 and does not exceed $16,000;

7 per centum of the amount by which the net income exceeds $16,000 and does not exceed $18,000;

8 per centum of the amount by which the net income exceeds $18,000 and does not exceed $20,000;

9 per centum of the amount by which the net income exceeds $20,000 and does not exceed $22,000;

10 per centum of the amount by which the net income exceeds $22,000 and does not exceed $24,000;

11 per centum of the amount by which the net income exceeds $24,000 and does not exceed $26,000;

12 per centum of the amount by which the net income exceeds $26,000 and does not exceed $28,000;

13 per centum of the amount by which the net income exceeds $28,000 and does not exceed $30,000;

14 per centum of the amount by which the net income exceeds $30,000 and does not exceed $32,000;

15 per centum of the amount by which the net income exceeds $32,000 and does not exceed $34,000;

16 per centum of the amount by which the net income exceeds $34,000 and does not exceed $36,000;

17 per centum of the amount by which the net income exceeds $36,000 and does not exceed $38,000;

18 per centum of the amount by which the net income exceeds $38,000 and does not exceed $40,000;

19 per centum of the amount by which the net income exceeds $40,000 and does not exceed $42,000;

20 per centum of the amount by which the net income exceeds $42,000 and does not exceed $44,000;

21 per centum of the amount by which the net income exceeds $44,000 and does not exceed $46,000;

22 per centum of the amount by which the net income exceeds $46,000 and does not exceed $48,000;

23 per centum of the amount by which the net income exceeds $48,000 and does not exceed $50,000;

24 per centum of the amount by which the net income exceeds $50,000 and does not exceed $52,000;

25 per centum of the amount by which the net income exceeds $52,000 and does not exceed $54,000;

26 per centum of the amount by which the net income exceeds $54,000 and does not exceed $56,000;

27 per centum of the amount by which the net income exceeds $56,000 and does not exceed $58,000;

28 per centum of the amount by which the net income exceeds $58,000 and does not exceed $60,000;

29 per centum of the amount by which the net income exceeds $60,000 and does not exceed $62,000;

30 per centum of the amount by which the net income exceeds $62,000 and does not exceed $64,000;

31 per centum of the amount by which the net income exceeds $64,000 and does not exceed $66,000;

32 per centum of the amount by which the net income exceeds $66,000 and does not exceed $68,000;

33 per centum of the amount by which the net income exceeds $68,000 and does not exceed $70,000;

34 per centum of the amount by which the net income exceeds $70,000 and does not exceed $72,000;

35 per centum of the amount by which the net income exceeds $72,000 and does not exceed $74,000;

36 per centum of the amount by which the net income exceeds $74,000 and does not exceed $76,000;

37 per centum of the amount by which the net income exceeds $76,000 and does not exceed $78,000;

38 per centum of the amount by which the net income exceeds $78,000 and does not exceed $80,000;

39 per centum of the amount by which the net income exceeds $80,000 and does not exceed $82,000;

40 per centum of the amount by which the net income exceeds $82,000 and does not exceed $84,000;

41 per centum of the amount by which the net income exceeds $84,000 and does not exceed $86,000;

42 per centum of the amount by which the net income exceeds $86,000 and does not exceed $88,000;

43 per centum of the amount by which the net income exceeds $88,000 and does not exceed $90,000;

44 per centum of the amount by which the net income exceeds $90,000 and does not exceed $92,000;

45 per centum of the amount by which the net income exceeds $92,000 and does not exceed $94.000;

46 per centum of the amount by which the net income exceeds $94,000 and does not exceed $96,000;

47 per centum of the amount by which the net income exceeds $96,000 and does not exceed $98,000;

48 per centum of the amount by which the net income exceeds $98,000 and does not exceed $100,000;

52 per centum of the amount by which the net income exceeds $100,000 and does not exceed $150,000;

56 per centum of the amount by which the net income exceeds $150,000 and does not exceed $200,000;

60 per centum of the amount by which the net income exceeds $200,000 and does not exceed $300,000;

63 per centum of the amount by which the net income exceeds $300,000 and does not exceed $500,000;

64 per centum of the amount by which the net income exceeds $500,000 and does not exceed $1,000,000;

65 per centum of the amount by which the net income exceeds $1,000,000.

(b) In the case of a bona fide sale of mines, oil or gas wells, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, the portion of the tax imposed by this section attributable to such sale shall not exceed 20 per centum of the selling price of such property or interest.

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

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

Net income.	Per cent.	Surtax.	Total surtax.
$5,000 to $6,000	1	$10	$10
$6,000 to $8,000	2	40	50
$8,000 to $10,000	3	60	110
$10,000 to $12,000	4	80	190
$12,000 to $14,000	5	100	290
$14,000 to $16,000	6	120	410
$16,000 to $18,000	7	140	550
$18,000 to $20,000	8	160	710
$20,000 to $22,000	9	180	890
$22,000 to $24,000	10	200	1,090
$24,000 to $26,000	11	220	1,310
$26,000 to $28,000	12	240	1,550
$28,000 to $30,000	13	260	1,810
$30,000 to $32,000	14	280	2,090
$32,000 to $34,000	15	300	2,390
$34,000 to $36,000	16	320	2,710
$36,000 to $38,000	17	340	3,050
$38,000 to $40,000	18	360	3,410
$40,000 to $42,000	19	380	3,790
$42,000 to $44,000	20	400	4,190
$44,000 to $46,000	21	420	4,610
$46,000 to $48,000	22	440	5,050
$48,000 to $50,000	23	460	5,510
$50,000 to $52,000	24	480	5,990
$52,000 to $54,000	25	500	6,490
$54,000 to $56,000	26	520	7,010
$56,000 to $58,000	27	540	7,550
$58,000 to $60,000	28	560	8,110
$60,000 to $62,000	29	580	8,690
$62,000 to $64,000	30	600	9,290
$64,000 to $66,000	31	620	9,910

Net income.	Per cent.	Surtax.	Total surtax.
$66,000 to $68,000	32	$640	$10,550
$68,000 to $70,000	33	660	11,210
$70,000 to $72,000	34	680	11,890
$72,000 to $74,000	35	700	12,590
$74,000 to $76,000	36	720	13,310
$76,000 to $78,000	37	740	14,050
$78,000 to $80,000	38	760	14,810
$80,000 to $82,000	39	780	15,590
$82,000 to $84,000	40	800	16,390
$84,000 to $86,000	41	820	17,210
$86,000 to $88,000	42	840	18,050
$88,000 to $90,000	43	860	18,910
$90,000 to $92,000	44	880	19,790
$92,000 to $94,000	45	900	20,690
$94,000 to $96,000	46	920	21,610
$96,000 to $98,000	47	940	22,550
$98,000 to $100,000	48	960	23,510
$100,000 to $150,000	52	26,000	49,510
$150,000 to $200,000	56	28,000	77,510
$200,000 to $300,000	60	60,000	137,510
$300,000 to $500,000	63	126,000	263,510
$500,000 to $1,000,000	64	320,000	583,510
$1,000,000 up	65		

The surtax for any amount of net income not shown in the above table is computed by adding to the total surtax for the largest amount shown which is less than the income the surtax upon the excess over that amount at the rate indicated in the table. For example, if the amount of net income is $63,128, the surtax is the sum of $8,690 (the surtax upon $62,000 as shown by the table) plus 30 per cent of $1,128, or $338.40, making a total surtax of $9,028.40.

ART. 13. **Surtax on sale of mineral deposits.**—Where the taxpayer by prospecting and locating claims, or by exploring and discovering undeveloped claims, has demonstrated the principal value of mines, oil or gas wells, which prior to his efforts had a relatively minor value, the portion of the surtax attributable to a sale of such property or of the taxpayer's interest therein shall not exceed 20 per cent of the selling price. Exploration work alone without discovery is not sufficient to bring a case within this provision. Shares of stock in a corporation owning mines, oil or gas wells, do not constitute an interest in such property. To determine the application of this provision to a particular case, the taxpayer should first compute the surtax in the ordinary way upon his net income, including his net income from any such sale. The proportion of the surtax indicated by the ratio which the taxpayer's net income from the sale of the property, or his interest therein computed as prescribed in article 715, bears to his total net income is the portion of the surtax attributable to such sale, and if it exceeds 20 per cent of the selling price of the property or interest such portion of the surtax shall be reduced to that amount. See articles 219–221.

NET INCOME DEFINED.

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

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

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

ART. 21. **Meaning of net income.**—The tax imposed by the statute is upon income. In the computation of the tax various classes of income must be considered: (*a*) Income (in the broad sense), meaning all wealth which flows in to the taxpayer other than as a mere return of capital. It includes the forms of income specifically described as gains and profits, including gains derived from the sale or other disposition of capital assets. It is not limited to cash alone, for the statute recognizes as income-determining factors other items, among which are inventories, accounts receivable, property exhaustion, and accounts payable for expenses incurred. See sections 202, 203, 213, and 214 of the statute. (*b*) Gross income, meaning income (in the broad sense) less income which is by statutory provision or otherwise exempt from the tax imposed by the statute. See section 213 and articles 71–86. (*c*) Net income, meaning gross income less statutory deductions. The statutory deductions are in general, though not exclusively, expenditures, other than capital expenditures, connected with the production of income. See sections 214 and 215 and the articles thereunder. (*d*) Net income less credits. See section 216 and articles 301–307. The surtax is imposed upon net income; the normal tax upon net income less credits. Though taxable net income is wholly a statutory conception it follows, subject to certain modifications as to exemptions and as to some of the deductions, the lines of commercial usage. Subject to these modifications statutory "net income" is commercial "net income." This appears from the fact that ordinarily it is to be computed in accordance with the method of accounting regularly employed in keeping the books of the taxpayer. As to the net income of corporations see section 232 and article 531.

ART. 22. **Computation of net income.**—Net income must be computed with respect to a fixed period. Usually that period is twelve months and is known as the taxable year. Items of income and of expenditures which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. See article 52. If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

ART. 23. **Bases of computation.**—(1) Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 200 of the statute for definitions of "paid," "paid or accrued," and "paid or incurred." All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. See section 213 (a). For instance, in any case in which it is necessary to use an inventory, no accounting in regard to purchases and sales will correctly reflect income except an accrual method. See section 213 (a) of the statute. A taxpayer is deemed to have received items of gross income which have been credited to or set apart for him without restriction. See article 53. On the other hand, appreciation in value of property is not even an accrual of income to a taxpayer prior to the realization of such appreciation through conversion of the property.

(2) For the taxable year 1918, the true income, computed under the Revenue Act of 1918 and—where the taxpayer keeps books of account—in accordance with the method of accounting regularly employed in keeping such books, shall in all cases be entered in the return, even though this results in apparent omissions or duplications of particular items of income or expense. In the ordinary case such

omissions and duplications are more apparent than real and are likely to counterbalance one another, so that the change in the basis of reporting calls for no material adjustment. Where, however, the method previously employed by the taxpayer in determining his income subject to the tax is materially different from the method regularly used by the taxpayer in keeping his accounts, or where for any reason the basis of reporting income subject to tax is changed, the taxpayer shall attach to his return a separate statement setting forth for the taxable year and for the preceding year the classes of items differently treated under the two systems, specifying in particular all amounts duplicated or entirely omitted as the result of such change. Where, for example, a taxpayer who, prior to 1918, has reported on the so-called receipts basis, is compelled under the above rule to report on the so-called accrual basis, he must include in the separate statement the following information:

First, (*a*) expenses paid before the end of the taxable year 1917 but not accrued at that date; (*b*) income accrued at the end of the taxable year 1917 but not received at that date; (*c*) expenses accrued at the end of the taxable year 1917 but not paid at that date; (*d*) income received before the end of the taxable year 1917 but not accrued at that date; and

Second, similar items as of the end of the taxable year 1916.

If in the opinion of the Commissioner such information indicates that the returns for any previous years did not reflect the true income, amended returns for such years will be required.

(3) A taxpayer who changes the method of accounting employed in keeping his books for the taxable year 1919 or thereafter shall, before computing his income upon such new basis for purposes of taxation, secure the consent of the Commissioner. Application for permission to change the basis of the return shall be made at least 30 days in advance of the original due date of the return and shall be accompanied by a statement specifying the classes of items differently treated under the two systems and specifying all amounts which would be duplicated or entirely omitted as a result of the proposed change.

(4) Banks which in the past have treated discount as income before it was actually earned and during the taxable year 1918 have placed the discount account upon an accrual basis will be required to submit the information called for in paragraph (2) of this article and submit an amended return for the taxable year 1917, and will be permitted to submit (or the Commissioner may require) amended returns for all prior years during which the taxpayer was subject to tax. Additional taxes for prior years found to be due upon such reexaminations will be paid upon the basis of the amended returns in the ordinary way. Where it appears that prior taxes have been paid in

excess of the amount properly due such excess will to the extent possible be credited against future income and profits taxes under the provisions of section 252 of the Revenue Act of 1918.

ART. 24. **Methods of accounting.**—It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Each taxpayer is required by law to make a return of his true income. He must, therefore, maintain such accounting records as will enable him to do so. See section 1305 of the statute and article 1711. Among the essentials are the following:

(1) In all cases in which the production, purchase, or sale of merchandise of any kind is an income-producing factor inventories of the merchandise on hand (including finished goods, work in process, raw materials, and supplies) should be taken at the beginning and end of the year and used in computing the net income of the year (see articles 1581–1588);

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

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

ART. 25. **Accounting period.**—The return of a taxpayer is made and his income computed for his taxable year, which means his fiscal year, or the calendar year if he has not established a fiscal year. The term "fiscal year" means an accounting period of twelve months ending on the last day of any month other than December. No fiscal year will, however, be recognized unless before its close it was definitely established as an accounting period by the taxpayer and the books of such taxpayer were kept in accordance therewith. The taxable year 1918 is the calendar year 1918 or any fiscal year ending during the calendar year 1918. See section 200 of the statute. A taxpayer having an existing accounting period which is a fiscal year within the meaning of the statute not only needs no permission to make his return on the basis of such a taxable year, but is required to do so, regardless of the former basis of rendering returns. A person having no such fiscal year must make return on the basis of the calendar year. The first return under the present statute of a taxpayer who has heretofore made return on a basis different from his accounting period will necessarily overlap his next previous return. For the method of adjusting the tax in such a case see section 205 of the statute and articles 1621–1624. Section 226 has no application to this situation. Except in the cases of a return for the taxable year 1918 and of a first return for income tax a taxpayer shall make his return on the basis (fiscal or calendar year) upon which he made his return for the taxable year immediately preceding unless, with the approval of the Commissioner, he has changed the basis of computing his net income.

ART. 26. **Change in accounting period.**—If a taxpayer changes his accounting period, and not merely his taxable year, to conform with his existing accounting period, he shall as soon as possible give to the collector for transmission to the Commissioner written notice of such change and of his reasons therefor. The Commissioner will not approve a change of the basis of computing net income unless such notice is given at a time which is both (*a*) at least thirty days before the original due date of the taxpayer's return on the basis of his existing taxable year and (*b*) at least thirty days before the due date of his separate return for the period between the close of the existing taxable year and the date designated as the close of the proposed taxable year. The due date of the separate return for such period is the fifteenth day of the third month following the close of that period. If the change in the basis of computing the net income of the taxpayer is approved by the Commissioner, the taxpayer shall thereafter make his returns upon the basis of the new accounting period in accordance with the requirements of section 226 of the statute and his net income shall be computed as therein provided. See article 431.

GROSS INCOME DEFINED: INCLUSIONS.

SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States,[1] and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such

[1] Regarding the constitutionality of this provision as applied to the salaries of the President and Federal judges see the case of *Evans* v. *Gore,* decided by the U. S. Supreme Court on June 1, 1920 (T. D. 3037).

items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; but * * *

Art. 31. **What included in gross income.**—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. See section 213 (b). Profits derived from sales in foreign commerce must be included in gross income. Income may be in the form of cash or of property. Dividends (other than stock dividends, see opinion of Supreme Court in case of Eisner *v.* Macomber, T. D. 3010) are taxed at the rates for the year in which paid. See section 201 of the statute and articles 1541–1549. The amount of income tax paid for a bondholder by an obligor pursuant to a tax-free covenant in its bonds is in the nature of additional interest paid the bondholder and must be included in his gross income. He is not, however, entitled to deduct from gross income the amount of such income tax paid on his behalf, but is entitled to credit such amount against his total income tax otherwise due. See sections 214 (a) 3 and 221 (b) of the statute and articles 565 and 566. As to the basis for determining gain or loss from sales see section 202 and articles 1561–1570. As to the gross income of corporations see section 233 and articles 541–550. In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets.

Art. 32. **Compensation for personal services.**—Where no determination of compensation is had until the completion of the services, the amount received is income for the taxable year of its determination, if the return is rendered on the accrual basis; or, for the taxable year in which received, if the return is rendered on a receipts and disbursements basis. Commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips, retired pay of Federal and other officers, and pensions or retiring allowances paid by the United States or private persons, are income to the recipients; as are also marriage fees, baptismal offerings, sums paid for saying masses for the dead, and other contributions received by a clergyman, evangelist, or religious worker for services rendered. However, so-called pensions awarded by one to whom no services have been rendered are mere gifts or gratuities and are not taxable. The salaries of Federal officers and employees are subject to tax, except that, in view of the provisions of the Constitution of the United States as construed by the Supreme Court, the salaries of the President of the United States and Federal judges are not subject to the tax if elected or appointed to office prior to the passage of the taxing statute. But see article 86. See further articles 85 and 105–108.

ART. 33. **Compensation paid other than in cash.**—Where services are paid for with something other than money, the fair market value of the thing taken in payment is the amount to be included as income. If the services were rendered at a stipulated price, in the absence of evidence to the contrary such price will be presumed to be the fair value of the compensation received. Compensation paid an employee of a corporation in its stock is to be treated as if the corporation sold the stock for its market value and paid the employee in cash. When living quarters such as camps are furnished to employees for the convenience of the employer, the ratable value need not be added to the cash compensation of the employee, but where a person receives as compensation for services rendered a salary and in addition thereto living quarters, the value to such person of the quarters furnished constitutes income subject to tax. Premiums paid by an employer on policies of group life insurance covering the lives of his employees, the beneficiaries of which are designated by the employees, are not income to the employees. See article 294.

ART. 34. **Compensation paid in notes.**—Promissory notes received in payment for services, and not merely as security for such payment, constitute income to the amount of their fair market value. A taxpayer receiving as compensation a note regarded as good for its face value at maturity, but not bearing interest, may properly treat as income as of the time of receipt the fair discounted value of the note at such time. Thus, if it appears that such a note is or could be discounted on a six or seven per cent basis, the recipient may include such note in his gross income to the amount of its face value less discount computed at the prevailing rate for such transactions. If the payments due on a note so accounted for are met as they become due, there should be included as income in respect of each such payment so much thereof as represents recovery for the discount originally deducted.

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

The allowance for amortization authorized by the statute must be taken by way of explicit deduction from gross income. See section 214 (a) (9) and articles 181–189. See also article 52.

ART. 36. **Long-term contracts.**—Persons engaged in contracting operations, who have uncompleted contracts, in some cases perhaps running for periods of several years, will be allowed to prepare their returns so that the gross income will be arrived at on the basis of completed work; that is, on jobs which have been finally completed any and all moneys received in payment will be returned as income for the year in which the work was completed. If the gross income is arrived at by this method, the deduction from such gross income should include and be limited to the expenditures made on account of such completed contracts. Or the percentage of profit from the contract may be estimated on the basis of percentage of expenditures, in which case the income to be returned each year during the performance of the contract will be computed upon the basis of the expenses incurred on such contract during the year; that is to say, if one-half of the estimated expenses necessary to the full performance of the contract are incurred during one year, one-half of the gross contract price should be returned as income for that year. Upon the completion of a contract if it is found that as a result of such estimate or apportionment the income of any year or years has been overstated or understated, the taxpayer must file amended returns for such year or years. See section 212 of the statute and articles 22–24.

ART. 37. **State contracts.**—Any profit received from a State or political subdivision thereof by an independent contractor is taxable income. Where warrants are issued by a city, town, or other political subdivision of a State, and are accepted by the contractor in payment for public work done, the face value of such warrants must be returned as income. If for any reason the contractor upon conversion of the warrants into cash does not receive and can not recover the full face value of the warrants so returned, he may allowably deduct from gross income for the year in which the warrants are converted into cash any loss sustained.

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

In the case of a farmer reporting on the accrual basis, (in which an inventory to determine profits is used) his gross profits are ascertained by adding to the inventory value of live stock and products on hand at the end of the year the amount received from the sale of live stock and products, and miscellaneous receipts for hire of teams, machinery, and the like, during the year, and deducting from this sum the inventory value of live stock and products on hand at the beginning of the year and the cost of live stock and products purchased during the year. In such cases all live stock raised or purchased for sale shall be included in the inventory at their proper valuation determined in accordance with the method authorized and adopted for the purpose. Also live stock acquired for draft, breeding, or dairy purposes and not for sale may be included in the inventory, instead of being treated as capital assets subject to depreciation, provided such practice is followed consistently by the taxpayer. In case of the sale of any live stock included in an inventory their cost must not be taken as an additional deduction in the return of income, as such deduction will be reflected in the inventory. See article 1586.

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

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

Form 1040 F shall be filled in and attached to his income tax return by every farmer who either keeps no records or only records of cash receipts and disbursements; its use is optional with other farmers. See further articles 110, 145 and 171.

ART. 39. **Sale of stock and rights.**—When shares of stock in a corporation are sold from lots purchased at different times and at different prices and the identity of the lots can not be determined the stock sold shall be charged against the earliest purchases of such stock. The excess of the amount realized on the sale over the cost of the stock, or its fair market value as of March 1, 1913, if purchased before that date, will be the profit to be accounted for as income. In the case of stock received as a stock dividend, and in the case of stock in respect of which any such dividend was paid, the cost of each share of such stock shall be ascertained as specified in article 1547. Where common stock is received as a bonus with the purchase of preferred stock or bonds, the total purchase price shall be fairly apportioned between the stock and securities purchased for the purpose of determining the portion of the consideration attributable to each class of stock or securities and so representing its cost, but if that should be impracticable in any case, no profit on any subsequent sale of any part of the stock or securities will be realized until out of the proceeds of sales shall have been recovered the total cost. See article 1565. The entire amount realized from the sale of rights to subscribe for stock is income.

ART. 40. **Sale of patents and copyrights.**—A taxpayer disposing of patents or copyrights by sale should determine the profit or loss arising therefrom by computing the difference between the selling price and the value as of March 1, 1913, if acquired prior to that date, or between the selling price and the cost, if acquired on or after that date. The profit or loss thus ascertained should be increased or decreased, as the case may be, by the amounts deducted on account of depreciation of such patents or copyrights since February 28, 1913, or since the date of acquisition if subsequent thereto. See article 167.

ART. 41. **Sale of good will.**—Any profit or loss resulting from a sale of good will can be taken only when the business, or a part of it, to which the good will attaches is sold, in which case the profit or loss will be determined upon the basis of the cost of the assets, including good will, or their fair market value as of March 1, 1913, if acquired prior thereto. If nothing was paid for good will acquired after February 28, 1913, no deductible loss with respect thereto is possible, although, on the other hand, upon the sale of the business there may be a profit. It is immaterial that good will may never have been carried on the books as an asset, but the burden of proof is on the taxpayer to establish the cost, or fair market value on March 1, 1913, of the good will sold. See article 163.

ART. 42. **Sale of personal property on installment plan.**—Dealers in personal property ordinarily sell either for cash or on the personal credit of the buyer or on the installment plan. Occasionally a fourth type of sale is met with, in which the buyer makes an initial payment of such a substantial nature (for example, a payment of more than 25 per cent) that the sale, though involving deferred payments, is not one on the installment plan. In sales on personal credit, and in the substantial payment type just mentioned, obligations of purchasers are to be regarded as the equivalent of cash, but a different rule applies to sales on the installment plan. Dealers in personal property who sell on the installment plan usually adopt one of four ways of protecting themselves in case of default: (*a*) Through an agreement that title is to remain in the seller until the buyer has completely performed his part of the transaction; (*b*) by a form of contract in which title is conveyed to the purchaser immediately, but subject to a lien for the unpaid portion of the purchase price; (*c*) by a present transfer of title to the purchaser, who at the same time executes a reconveyance in the form of a chattel mortgage to the seller; or (*d*) by conveyance to a trustee pending performance of the contract and subject to its provisions. The general purpose and effect being the same in all of these plans, it is desirable that a uniformly applicable rule be established. The rule prescribed is that in the sale or contract for sale of personal property on the installment plan, whether or not title remains in the vendor until the property is fully paid for, the income to be returned by the vendor will be that proportion of each installment payment which the gross profit to be realized when the property is paid for bears to the gross contract price. Such income may be ascertained by taking as profit that proportion of the total cash collections received in the taxable year from installment sales (such collections being allocated to the year against the sales of which they apply), which the annual gross profit to be realized on the total installment sales made during each year bears to the gross contract price of all such sales made during that respective year. In any case where the gross profit to be realized on a sale or contract for sale of personal property has been reported as income for the year in which the transaction occurred, and a change is made to the installment plan of computing net income, no part of any installment payment received subsequent to the change, representing income previously reported on account of such transaction, should be reported as income for the year in which the installment payment is received; the intent and purpose of this provision is that where the entire profit from installment sales has been included in gross income for the year in which the sale was made, no part of the installment payments received subsequently on account of such previous sales shall again be subject to tax for the year or years in which received. Where the taxpayer makes a change to this method of computing net income his balance sheet should be adjusted conformably. If for any reason the vendee defaults in any of his installment payments and the vendor repossesses the property, the entire amount received on installment payments, less the profits already returned, will be income of the vendor for the year in which the property was repossessed, and the property repossessed must be included in the inventory at its original cost to himself, less proper allowance for damage and use, if any. If the vendor chooses as a matter of consistent practice to treat the obligations of purchasers as the equivalent of cash, such a course is permissible.

Art. 43. **Sale of real estate in lots.**—Where a tract of land is purchased with a view to dividing it into lots or parcels of ground to be sold as such, the entire fair market value as of March 1, 1913, or the cost, if acquired on or after that date, shall be equitably apportioned to the several lots or parcels and made a matter of record in the books of the taxpayer, to the end that any gain derived from the sale of any such lots or parcels may be returned as income for the year in which the sale was made. This rule contemplates that there will be a measure of gain or loss in every lot or parcel sold, and not that the capital invested in the entire tract shall be extinguished before any taxable income shall be returned. The sale of each lot or parcel will be treated as a separate transaction and the gain or loss will be accounted for accordingly.

Art. 44. **Sale of real estate involving deferred payments.**—Deferred payment sales of real estate ordinarily fall into two classes when considered with respect to the terms of sale, as follows:

(1) Installment transactions, in which the initial payment is relatively small (generally less than one-fourth of the purchase price) and the deferred payments usually numerous and of small amount. They include (*a*) sales where there is immediate transfer of title when a small initial payment is made, the seller being protected by a mortgage or other lien as to deferred payments, and (*b*) agreements of purchase and sale which contemplate that a conveyance is not to be made at the outset, but only after all or a substantial portion of the agreed installments have been paid.

(2) Deferred payment sales not on the installment plan, in which there is a substantial initial payment (ordinarily not less than one-fourth of the purchase price), deferred payments being secured by a

mortgage or other lien. Such sales are distinguished from sales on the installment plan by the substantial character of the initial payment and also usually by a relatively small number of deferred payments.

In determining how these classes shall be treated in levying the income tax, the question in each case is whether the income to be reported for taxation shall be based only on amounts actually received in a taxing year, or on the entire consideration made up in part of agreements to pay in the future.

ART. 45. **Sale of real estate on installment plan.**—In the two kinds of transactions included in class (1) in the foregoing article, installment obligations assumed by the buyer are not ordinarily to be regarded as the equivalent of cash, and the vendor may report as his income from such transactions in any year that proportion of each payment actually received in that year which the gross profit to be realized when the property is paid for bears to the gross contract price. If the return is made on this basis and the vendor repossesses the property after default by the buyer, retaining the previous payments, the entire amount of such payments, less the profit previously returned, will be income to the vendor and will be so returned for the year in which the property was repossessed, and the property repossessed must be included in the inventory at its original cost to himself (less any depreciation as defined in articles 161 and 162). If the taxpayer chooses as a matter of settled practice consistently followed to treat the obligations of the purchaser as equivalent to cash and to report the profit derived from the entire consideration, cash and deferred payments, as income for the year when the sale is made, this is permissible. If so treated the rule prescribed in article 46 will apply.

ART. 46. **Deferred payment sales of real estate not on installment plan.**—In class (2) in article 44 the obligations assumed by the buyer are much better secured because of the margin afforded by the substantial first payment, and experience shows that the greater number of such sales are eventually carried out according to their terms. These obligations for deferred payments are therefore to be regarded as equivalent to cash, and the profit indicated by the entire consideration is taxable income for the year in which the initial payment was made and the obligations assumed. If the buyer defaults and the seller regains title to the land by agreement or process of law, retaining payments previously made, he may deduct from his gross income as a loss in the year of repossession any excess of the amount previously reported as income over the amount actually received, and must include such real estate in his inventory at its original cost to himself (less any depreciation as defined in articles 161 and 162). See article 153.

ART. 47. **Annuities and insurance policies.**—Annuities paid by religious, charitable, and educational corporations under an annuity contract are subject to tax to the extent that the aggregate amount of the payments to the annuitant exceeds any amounts paid by him as consideration for the contract. An annuity charged upon devised land is income taxable to the annuitant, whether paid by the devisee out of the rents of the land or from other sources. The devisee is not required to return as taxable income the amount of rent paid to the annuitant, and he is not entitled to deduct from his taxable income any sums paid to the annuitant. Where an insured receives under life insurance, endowment, or annuity contracts sums in excess of the premiums paid therefor, such excess is income for the year of its receipt. See article 72. Distributions on paid-up policies which are made out of earnings of the insurance company subject to tax are in the nature of corporate dividends and are income of an individual only for the purpose of the surtax.

ART. 48. **Improvements by lessees.**—When buildings are erected or improvements are made by a lessee in pursuance of an agreement with the lessor, and such buildings or improvements are not subject to removal by the lessee, the lessor receives income at the time when such buildings or improvements are completed, to the extent of the fair market price or value of such buildings or improvements subject to the lease. This amount would ordinarily be the difference between the value of the land free from the lease without such improvements and the value of the land subject to the lease with such improvements. If, for any other reason than a bona fide purchase from the lessee by the lessor, the lease is terminated, so that the lessor comes into possession and control of the property prior to the time originally fixed for the termination of the lease, the lessor receives additional income for the year in which the lease is so terminated to the extent that the value of such buildings or improvements when he became entitled to such possession exceeds the fair market price or value thereof to him as determined when the same completed became part of the realty. No appreciation in value due to causes other than the premature termination of the lease shall be included. Conversely, if the buildings or improvements are destroyed prior to the termination of the lease the lessor is entitled to deduct as a loss of the year when such destruction takes place the fair market price or value of such buildings or improvements subject to the lease as determined when the same completed became a part of the realty, or the value thereof subject to the lease on March 1, 1913, less any salvage value subject to the lease, to the extent that such loss was not compensated by insurance. See articles 109 and 164.

ART. 49. **Compensation for loss.**—In the case of property which has been lost or destroyed in whole or in part through fire, storm, shipwreck, or other casualty, or where the owner of property has lost or transferred title by reason of the exercise of the power of requisition or eminent domain, including cases where a voluntary transfer or conveyance is induced by reason of the fact that a technical requisition or condemnation proceeding is imminent, the amount received by the owner as compensation for the property may show an excess over the value of the property on March 1, 1913, or over its cost, if it was acquired on or after that date (after making proper provision in either case for depreciation to the date of the loss, damage, or transfer). The transaction is not regarded as completed at this stage, however, if the taxpayer proceeds immediately in good faith to replace the property, or if he makes application to establish a replacement fund as provided in the following article. In such a case the gain, if any, is measured by the excess of the amount received over the amount actually and reasonably expended to replace or restore the property substantially in kind, exclusive of any expenditures for additions or betterments. The new or restored property effects a replacement in kind only to the extent that it serves the same purpose as the property which it replaces without added capacity or other element of additional value. Such new or restored property shall not be valued in the accounts of the taxpayer at an amount in excess of the cost or value at March 1, 1913, if acquired before that date (after making proper provision in either case for depreciation to the date of the loss, damage, or transfer), of the original property, plus the cost of any actual additions and betterments. If the taxpayer does not elect to replace or restore the property, the transaction will then be deemed to be completed and the income shall be measured by the excess of the amount of the compensation received over the cost of the property or its actual value at March 1, 1913, if acquired before that date (after making proper provision in either case for depreciation to the date of the loss, damage, or transfer). See article 141. Articles 49 and 50 have no application to property which is voluntarily sold or disposed of.

ART. 50. **Replacement fund for loss.**—In any case in which the taxpayer elects to replace or restore the lost, damaged, or transferred property, but where it is not practicable to do so immediately, he may obtain permission to establish a replacement fund in his accounts in which the entire amount of the compensation so received shall be held, without deduction for the payment of any mortgage, and pending the disposition thereof the accounting for gain or loss thereupon may be deferred for a reasonable period of time, to be determined by the Commissioner. In such a case the taxpayer should make application to the Commissioner on form 1114 for permission to establish such a replacement fund and in his application should recite all the facts relating to the transaction and undertake that he will proceed as expeditiously as possible to replace or restore such property. The taxpayer will be required to furnish a bond with such surety as the Commissioner may require for an amount not less than the estimated additional income and war profits and excess profits taxes assessable by the United States upon the income so carried to the replacement fund. See section 1320 of the statute. The estimated additional taxes, for the amount of which the claimant is required to furnish security, should be computed at the rates at which the claimant would have been obliged to pay, taking into consideration the remainder of his net income and resolving against him all matters in dispute affecting the amount of the tax. Only surety companies holding certificates of authority from the Secretary of the Treasury as acceptable sureties on Federal bonds will be approved as sureties. The application should be executed in triplicate, so that the Commissioner, the applicant and the surety or depositary may each have a copy.

ART. 51. **Forgiveness of indebtedness.**—The cancellation and forgiveness of indebtedness is dependent on the circumstances for its effect. It may amount to a payment of income or to a gift or to a capital transaction. If, for example, an individual performs services for a creditor, who in consideration thereof cancels the debt, income to that amount is realized by the debtor as compensation for his services. If, however, a creditor merely desires to benefit a debtor and without any consideration therefor cancels the debt, the amount of the debt is a gift from the creditor to the debtor and need not be included in the latter's gross income. If a stockholder in a corporation which is indebted to him gratuitously forgives the debt, the transaction amounts to a contribution to the capital of the corporation. See sections 213 (b) (3) and 240 of the statute and articles 543 and 631–638.

ART. 52. **When included in gross income.**—Gains, profits and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included when they accrue to him in accordance with the approved method of accounting followed by him. See articles 21–24. Lands which are received as compensation for services in one year, the title to which is disputed and in a later year adjudged to be valid, constitute income to the grantee in the former year. On the other hand, a person may sue in one year on a pecuniary claim or for property, but money or property recovered on a judgment therefor rendered in a later year would be income in that year, assuming that it would have been income in the earlier year if then received. This is true of a recovery for patent infringement. Bad debts or accounts charged off because of the fact that they were determined to be worthless, which are subsequently recovered, whether or not by suit, constitute income for the year in which recovered, regardless of the date when the amounts were charged off. See articles 111 and 151. In view of the unusual conditions prevailing at the close of the year 1918 it is recognized that many items of gross income, such as claims for compensation under cancelled contracts, together with claims against contracting departments of the Government for amortization and other matters, while properly constituting gross income for the taxable year 1918 were undecided and not sufficiently definite in amount to be reported in the original return for that year. In every such case the taxpayer should attach to his return a full statement of such pending claims and other matters, and when the correct amount of such items is ascertained an amended return for the taxable year 1918 should be filed.

ART. 53. **Income not reduced to possession.**—Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made. A book entry, if made, should indicate an absolute transfer from one account to another. If the income is not credited, but is set apart, such income must be unqualifiedly subject to the demand of the taxpayer. Where a corporation contingently credits its employees with bonus stock, but the stock is not available to such employees until the termination of five years of employment, the mere crediting on the books of the corporation does not constitute receipt. The distinction between receipt and accrual must be kept in mind. Income may accrue to the taxpayer and yet not be subject to his demand or capable of being drawn on or against by him.

ART. 54. **Examples of constructive receipt.**—Where interest coupons have matured, but have not been cashed, such interest payment, though not collected when due and payable, is nevertheless available to the taxpayer and should therefore be included in his gross income for the year during which the coupons matured. This is true if the coupons are exchanged for other property instead of eventually being cashed. Dividends on corporate stock are subject to tax when set apart for the stockholder, although not yet collected by him. See section 201 of the statute and articles 1541–1549. The distributive share of the profits of a partner in a partnership or of a stockholder in a personal service corporation is regarded as received by him, although not distributed. See section 218 of the statute and articles 321–335. Interest credited on savings bank deposits, even though the bank nominally have a rule, seldom or never enforced, that it may require so many days' notice in advance of cashing depositors' checks, is income to the depositor when credited. An amount credited to shareholders of a building and loan association, when such credit passes without restriction to the shareholder, has a taxable status as income for the year of the credit. Where the amount of such accumulations does not become available to the shareholder until the maturity of a share, the amount of any share in excess of the aggregate amount paid in by the shareholder is income for the year of the maturity of the share.

GROSS INCOME DEFINED: EXCLUSIONS.

[SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income" —]

(b) Does not include the following items, which shall be exempt from taxation under this title:

(1) The proceeds of life insurance policies paid upon the death of the insured to individual beneficiaries or to the estate of the insured;

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

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

(4) Interest upon (a) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (b) securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916; or (c) the obligations of the United States or its possessions; or (d) bonds issued by the War Finance Corporation: *Provided*, That every person owning any of the obligations, securities or bonds enumerated in clauses (a), (b), (c), and (d) shall, in the return required by this title, submit a statement showing the number and amount of such obligations, securities and bonds owned by him and the income received therefrom, in such form and with such information as the Commissioner may require. In the case of obligations of the United States issued after September 1, 1917, and in the case of bonds issued by the War Finance Corporation, the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt from taxation to the taxpayer both under this title and under Title III;

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

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

(7) Income derived from any public utility or the exercise of any essential governmental function and accruing to any State, Territory, or the District of Columbia, or any political subdivision of a State or

Territory, or income accruing to the government of any possession of the United States, or any political subdivision thereof.

Whenever any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, prior to September 8, 1916, entered in good faith into a contract with any person, the object and purpose of which is to acquire, construct, operate, or maintain a public utility, no tax shall be levied under the provisions of this title upon the income derived from the operation of such public utility, so far as the payment thereof will impose a loss or burden upon such State, Territory, District of Columbia, or political subdivision; but this provision is not intended to confer upon such person any financial gain or exemption or to relieve such person from the payment of a tax as provided for in this title upon the part or portion of such income to which such person is entitled under such contract;

(8) So much of the amount received during the present war by a person in the military or naval forces of the United States as salary or compensation in any form from the United States for active services in such forces, as does not exceed $3,500. * * *

ART. 71. **What excluded from gross income.**—Gross income excludes the items of income specifically exempted by the statute and also certain other kinds of income by statute or fundamental law free from tax. Such tax-free income should not be included in the return of income and need not be mentioned in the return, unless information regarding it is specifically called for, as in the case, for example, of interest on municipal bonds. See article 402. The exclusion of such income should not be confused with the reduction of taxable income by the application of allowable deductions. See section 212 of the statute and article 21. As to exclusions from gross income by corporations, see section 233 and article 541.

ART. 72. **Proceeds of insurance.**—(*a*) Upon the death of an insured the proceeds of his life insurance policies, whether paid to his estate or to individual beneficiaries (including partnerships), directly or in trust, are excluded from the gross income of the beneficiary. See article 541. (*b*) During his life only so much of the amount received by an insured under life, endowment or annuity contracts as represents a return, without interest, of premiums paid by him therefor is excluded from his gross income. See article 47. (*c*) Whether he be alive or dead, the amounts received by an insured or his estate or other beneficiaries through accident or health insurance or under workmen's compensation acts as compensation for personal injuries or sickness are excluded from the gross income of the insured, his estate and other beneficiaries. Any damages recovered by suit or agreement on account of such injuries or sickness are similarly excluded from the gross income of the individual injured or sick, if living, or of his estate or other beneficiaries entitled to receive such damages, if dead. See further article 294. Since June 25, 1918, no assessment of any Federal tax may be made on any allotments, family allowances, compensation, or death or disability insurance payable under the War Risk Insurance Act of September 2, 1914, as amended, even though the benefit accrued before that date.

ART. 73. **Gifts and bequests.**—Money and real or personal property received as gifts, or received under a will or under statutes of descent and distribution, are exempt from tax, although the income therefrom derived from investment, sale or otherwise is not. See section 202 of the statute and articles 32, 51, and 1562. An amount of principal paid under a marriage settlement is a gift. Neither alimony nor an allowance based on a separation agreement is taxable income. See article 291.

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

ART. 75. **Dividends and interest from Federal land bank and national farm loan association.**—As section 26 of the Federal Farm Loan Act of July 17, 1916, provides that every Federal land bank and every national farm loan association, including the capital and reserve or surplus therein and the income derived therefrom, shall be exempt from taxation, except taxes upon real estate, and that farm loan bonds, with the income therefrom, shall be exempt from taxation, the income derived from dividends on stock of Federal land banks and national farm loan associations and from interest on such farm loan bonds is not subject to the income tax. See also section 231 (13) of the statute.

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

ART. 77. **Interest upon United States obligations.**—Although interest upon the obligations of the United States and its possessions is in general exempt from tax, in the case of obligations issued by the United States after September 1, 1917, which include Treasury certificates of indebtedness, war savings certificates, the liberty bond issues (except the first liberty loan 3½ per cent bonds), and Victory notes, the interest is exempt from tax only if and to the extent provided in the acts authorizing the issue thereof, as amended and supplemented. Interest credited to postal savings accounts upon moneys deposited in postal savings banks on or before September 1, 1917, is exempt from income tax, while interest credited upon deposits made subsequent to September 1, 1917, is liable to tax. Interest on the first liberty loan 3½ per cent bonds is entirely exempt from tax, but that absolute exemption does not extend to the bonds of the first liberty loan converted.

ART. 78. **Liberty bond exemption under Second, Third, and Fourth Liberty Bond Acts.**—The Second Liberty Bond Act of September 24, 1917, as amended by the Third Liberty Bond Act of April 4, 1918, and by the Fourth Liberty Bond Act of July 9, 1918, provides:

> SEC. 7. That none of the bonds authorized by section one, nor of the certificates authorized by section five, or by section six, of this act, shall bear the circulation privilege. All such bonds and certificates shall be exempt, both as to principal and interest from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (a) estate or inheritance taxes, and (b) graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations. The interest on an amount of such bonds and certificates the principal of which does not exceed in the aggregate $5,000, owned by any individual, partnership, association, or corporation, shall be exempt from the taxes provided for in subdivision (b) of this section.

Accordingly, in addition to the interest on first liberty loan 3½ per cent bonds, which is entirely free from tax, all interest on first liberty loan converted 4 per cent bonds, first liberty loan converted 4¼ per cent bonds, first liberty loan second converted 4¼ per cent bonds, second liberty loan 4 per cent bonds, second liberty loan converted $4\frac{1}{4}$ per cent bonds, third liberty loan $4\frac{1}{4}$ per cent bonds, and fourth liberty loan $4\frac{1}{4}$ per cent bonds, together with all interest on United States certificates of indebtedness and war savings certificates, is exempt from the normal tax. Such interest in excess of the interest on not exceeding $5,000 principal amount of such bonds and certificates may, however, be subject to surtax and to the war profits and excess profits tax and may accordingly require to be included in gross income.

ART. 79. **Liberty bond exemption under Supplement to Second Liberty Bond Act.**—Section 7 of the Second Liberty Bond Act provides that the interest on an aggregate of not exceeding $5,000 principal amount of liberty bonds of issues after the first, owned by any person, including in such later issues bonds of the first liberty loan converted, Treasury certificates and war savings certificates, shall be exempt from surtaxes and war profits and excess profits taxes, as well as the normal tax. The Supplement to Second Liberty Bond Act, approved September 24, 1918, provides:

> That until the expiration of two years after the date of the termination of the war between the United States and the Imperial German Government, as fixed by proclamation of the President—
>
> (1) The interest on an amount of bonds of the Fourth Liberty Loan the principal of which does not exceed $30,000 owned by any individual, partnership, association, or corporation, shall be exempt from graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations;
>
> (2) The interest received after January 1, 1918, on an amount of bonds of the First Liberty Loan Converted, dated either November 15, 1917, or May 9, 1918, the Second Liberty Loan, converted and unconverted, and the Third Liberty Loan, the principal of which does not exceed $45,000 in the aggregate, owned by any individual, partnership, association, or corporation, shall be exempt from such taxes: *Provided, however*, That no owner of such bonds shall be entitled to such exemption in respect to the interest on an aggregate principal amount of such bonds exceeding one and one-half times the principal amount of bonds of the Fourth Liberty Loan originally subscribed for by such owner and still owned by him at the date of his tax return; and
>
> (3) The interest on an amount of bonds, the principal of which does not exceed $30,000, owned by any individual, partnership, association, or corporation, issued upon conversion of $3\frac{1}{2}$ per centum bonds of the First Liberty Loan in the exercise of any privilege arising as a consequence of the issue of bonds of the Fourth Liberty Loan, shall be exempt from such taxes.
>
> The exemptions provided in this section shall be in addition to the exemption provided in section 7 of the Second Liberty Bond Act in respect to the interest on an amount of bonds and certificates, authorized by such Act and amendments thereto, the principal of which does not exceed in the aggregate $5,000, and in addition to all other exemptions provided in the Second Liberty Bond Act.

Accordingly, the exemption from surtaxes and war profits and excess profits taxes covers, and there may be excluded from gross income, the interest received on not exceeding $5,000 principal amount in the aggregate of first liberty loan converted 4 per cent bonds, first liberty loan converted 4¼ per cent bonds, first liberty loan second converted 4¼ per cent bonds, second liberty loan 4 per cent bonds, second liberty loan converted 4¼ per cent bonds, third liberty loan 4¼ per cent bonds, fourth liberty loan 4¼ per cent bonds, and Treasury certificates and war savings certificates, apportioned as the taxpayer may choose; and in addition, until the expiration of two years after the termination of the war, (*a*) the interest received on not exceeding $30,000 principal amount of fourth liberty loan 4¼ per cent bonds; plus (*b*) the interest received on an aggregate principal amount of first liberty loan converted 4 per cent bonds, first liberty loan converted 4¼ per cent bonds (dated May 9, 1918), second liberty loan bonds, converted and unconverted, and third liberty loan 4¼ per cent bonds, not exceeding $45,000 and not exceeding 150 per cent of the principal amount of bonds of the fourth liberty loan both originally subscribed for by the taxpayer and still owned by him at the date of his return; plus (*c*) the interest received on not exceeding $30,000 principal amount of first liberty loan second converted 4¼ per cent bonds (dated October 24, 1918).

ART. 80. **Liberty bond exemption after December 31, 1918.**—The Victory Liberty Loan Act of March 3, 1919, provides:

SEC. 2. (a) That until the expiration of five years after the date of the termination of the war between the United States and the German Government, as fixed by proclamation of the President, in addition to the exemptions provided in section 7 of the Second Liberty Bond Act in respect to the interest on an amount of bonds and certificates, authorized by such Act and amendments thereto, the principal of which does not exceed in the aggregate $5,000, and in addition to all other exemptions provided in the Second Liberty Bond Act or the Supplement to Second Liberty Bond Act, the interest received on and after January 1, 1919, on an amount of bonds of the First Liberty Loan Converted, dated November 15, 1917, May 9, 1918, or October 24, 1918, the Second Liberty Loan converted and unconverted, the Third Liberty Loan, and the Fourth Liberty Loan, the principal of which does not exceed $30,000 in the aggregate, owned by any individual, partnership, association, or corporation, shall be exempt from graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations.

(b) In addition to the exemption provided in subdivision (a), and in addition to the other exemptions therein referred to, the interest received on and after January 1, 1919, on an amount of the bonds therein specified the principal of which does not exceed $20,000 in the aggregate, owned by any indivdual, partnership, association, or corporation, shall be exempt from the taxes therein specified: *Pro-*

> *vided,* That no owner of such bonds shall be entitled to such exemption in respect to the interest on an aggregate principal amount of such bonds exceeding three times the principal amount of notes of the Victory Liberty Loan originally subscribed for by such owner and still owned by him at the date of his tax return.

Accordingly, with respect to the interest on Liberty bonds received after December 31, 1918, the exemption from surtaxes and war profits and excess profits taxes covers, and there may be excluded from gross income, in addition to the exemptions specified in articles 77, 78, and 79, (*a*) the interest received on and after January 1, 1919, until the expiration of five years after the termination of the war, on not exceeding $30,000 principal amount in the aggregate of first Liberty loan converted 4 per cent bonds, first Liberty loan converted 4¼ per cent bonds, first Liberty loan second converted 4¼ per cent bonds, second Liberty loan 4 per cent bonds, second Liberty loan converted 4¼ per cent bonds, third Liberty loan 4¼ per cent bonds, and fourth Liberty loan 4¼ per cent bonds, apportioned as the taxpayer may choose; and in addition (*b*) the interest received on and after January 1, 1919, during the life of the notes of the Victory Liberty loan, on an aggregate principal amount of the bonds described in subdivision (*a*) not exceeding $20,000 and not exceeding three times the principal amount of notes of the Victory Liberty loan originally subscribed for by the taxpayer and still owned by him at the date of his return. The specific exemptions of notes of the Victory Liberty loan are those prescribed by the Secretary of the Treasury pursuant to the Victory Liberty Loan Act. The Victory Liberty loan 3¾ per cent convertible gold notes are exempt, both as to principal and interest, from all taxation except estate or inheritance taxes, now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority. The Victory Liberty loan 4¾ per cent convertible gold notes are exempt, both as to principal and interest, from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (*a*) estate or inheritance taxes, and (*b*) graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations.

For the purposes of the additional tax exemption for Liberty bonds granted by section 2 (b) of the Victory Liberty Loan Act, approved March 3, 1919, Victory notes of either series issued upon conversion of Victory notes of the other series which were originally subscribed for by any taxpayer will be deemed to have been originally subscribed for by such taxpayer.

All interest accrued on 4¾ per cent Victory notes at the date of any conversion by the taxpayer into 3¾ per cent Victory notes will, for the purposes of computing net income, be deemed to be interest upon 4¾ per cent Victory notes, and will be entitled only to the exemptions from taxation to which interest on 4¾ per cent Victory notes is entitled. Any and all amounts received by any taxpayer from the United States by way of adjustment of accrued interest upon conversion of 4¾ per cent Victory notes into 3¾ per cent Victory notes will be deemed to be interest upon 4¾ per cent Victory notes.

All interest accrued on 3¾ per cent Victory notes at the date of any conversion by the taxpayer into 4¾ per cent Victory notes will, for the purposes of computing net income, be deemed to be interest upon 3¾ per cent Victory notes, and will be entitled to the exemptions from taxation to which interest on 3¾ per cent Victory notes is entitled.

ART. 80(a). **Summary of tax exemptions of Liberty bonds and Victory notes.**—Liberty bonds and Victory notes issued under authority of the acts of Congress approved April 24, 1917, September 24, 1917, April 4, 1918, July 9, 1918, September 24, 1918, and March 3, 1919, are entitled, respectively, to the exemptions from taxation set forth in said acts, from which the statements in this article are summarized, and to which they are subject.

I. 4 per cent and 4¼ per cent Liberty bonds and 4¾ per cent Victory notes are exempt from all Federal, State, and local taxation, except (*a*) estate or inheritance taxes, and (*b*) Federal income surtaxes and profits taxes, as follows:

1. First Liberty loan converted 4 per cent bonds of 1932–1947 (first 4s).
2. First Liberty loan converted 4¼ per cent bonds of 1932–1947 (first 4¼s, issue of May 9, 1918).
3. First Liberty loan second converted 4¼ per cent bonds of 1932–1947 (first 4¼s, issue of Oct. 24, 1918).
4. Second Liberty loan 4 per cent bonds of 1927–1942 (second 4s).
5. Second Liberty loan converted 4¼ per cent bonds of 1927–1942 (second 4¼s).
6. Third Liberty loan 4¼ per cent bonds of 1928 (third 4¼s).
7. Fourth Liberty loan 4¼ per cent bonds of 1933–1938 (fourth 4¼s).
8. Victory Liberty loan 4¾ per cent convertible gold notes of 1922–1923 (4¾ per cent Victory notes).

are exempt, both as to principal and interest, from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (*a*) estate or inheritance taxes, and (*b*) graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations.

II. 4 per cent and 4¼ per cent Liberty bonds (but not 4¾ per cent Victory notes), Treasury certificates, and war savings certificates are entitled to certain limited exemptions from graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations, in respect to the interest on principal amounts thereof, as follows:

$5,000	in the aggregate of first 4s, first 4¼s (issues of May 9 and Oct. 24, 1918), second 4s and 4¼s, third 4¼s, fourth 4¼s, Treasury certificates, and war-savings certificates.
30,000	of first 4¼s (issue of Oct. 24, 1918, only), until the expiration of two years after the termination of the war.
30,000	of fourth 4¼s, until the expiration of two years after the termination of the war.
30,000	in the aggregate of first 4s, first 4¼s (issues of May 9 and Oct. 24, 1918), second 4s and 4¼s, third 4¼s, and fourth 4¼s, as to the interest received on and after January 1, 1919, until the expiration of five years after the termination of the war.
45,000	in the aggregate of first 4s, first 4¼s (issue of May 9, 1918, only), second 4s and 4¼s, and third 4¼s, as to the interest received after January 1, 1918, until the expiration of two years after the termination of the war; this exemption conditional on original subscription to, and continued holding at the date of the tax return of, two-thirds as many bonds of the fourth Liberty loan.
20,000	in the aggregate of first 4s, first 4¼s (issues of May 9 and Oct. 24, 1918), second 4s and 4¼s, third 4¼s, and fourth 4¼s, as to the interest received on and after January 1, 1919; this exemption conditional upon original subscription to, and continued holding at the date of the tax return of, one-third as many notes of the Victory Liberty loan, and extending through the life of such notes of the Victory Liberty loan.
160,000	total possible exemptions from Federal income surtaxes and profits taxes, subject to conditions above summarized.

III. 3½ per cent bonds and 3¾ per cent notes are exempt from all Federal, State, and local taxation, except estate or inheritance taxes, as follows:

1. First Liberty loan 3½ per cent bonds of 1932–1947. 2. Victory Liberty loan 3¾ per cent convertible gold notes of 1922–1923.	are exempt, both as to principal and interest, from all taxation (except estate or inheritance taxes) now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority.

ART. 81. **Liberty bond exemption in the case of trusts.**—(*a*) When income is taxable to beneficiaries, as in the case of a trust the income of which is to be distributed to the beneficiaries periodically, each beneficiary is regarded as the owner of a proportionate part of the bonds held in trust and is entitled to exemption on account of such

ownership as if he owned such proportionate part of the bonds directly. In such a case a subscription by a trustee for bonds of the fourth Liberty loan, or notes of the Victory Liberty loan, constitutes each beneficiary existing at the time of such subscription an original subscriber for his proportionate part of such bonds or notes, as the case may be, and entitles such beneficiary to the appropriate collateral exemption of interest on bonds of previous issues, whether owned by such beneficiary or by the trustee, as if the beneficiary had himself originally subscribed for such proportionate part of the bonds or notes; and a subscription by such beneficiary for bonds of the fourth Liberty loan or notes of the Victory Liberty loan, as the case may be, entitles him to the appropriate collateral exemption of interest on bonds of previous issues held by the trustee. (*b*) When, on the other hand, income is taxable to the trustee, as in the case of a trust the income of which is accumulated for the benefit of unborn or unascertained persons, the trustee is regarded as the owner of all the bonds held in trust and the trust is entitled to exemption on account of such ownership. In such a case a subscription by a trustee constitutes the trustee as such the original subscriber and entitles the trust, on account of such subscription, to the collateral exemption of interest on bonds of previous issues. As to exemptions in the case of bonds beneficially owned by nonresident aliens, see article 93.

ART. 82. **Liberty bond exemption in the case of partnerships and personal service corporations.**—As income of a partnership is taxable to the individual partners, each partner is treated as the owner of a proportionate part of the bonds held by the partnership and is entitled to exemption on account of such ownership as if such partner owned such proportionate part of the bonds directly. Such partner, if a partner at the time of the original subscription by the partnership for bonds of the fourth Liberty loan or notes of the Victory Liberty loan, as the case may be, is treated as an original subscriber for a proportionate part of such bonds or notes subscribed for by the partnership and is entitled to the appropriate collateral exemption of interest on bonds of previous issues on account of such original subscription for bonds or notes as if he had subscribed directly for such proportionate part. This principle also applies to stockholders in personal service corporations.

ART. 83. **Income of foreign Governments.**—The exemption of income of foreign Governments applies also to their political subdivisions. Any income collected by foreign Governments from investments in the United States in stocks, bonds, or other domestic securities, which are not actually owned by but are loaned to such foreign Governments, is subject to tax. The income of foreign ambassadors and ministers from investments in bonds and stocks and from interest on bank balances, and the fees of foreign consuls, are exempt from tax, but income of such foreign officials from any business carried on by them in the United States would be taxable. The compensation of citizens of the United States who are officers or employees of a foreign Government is, however, not exempt from tax.

ART. 84. **Income of States.**—Income derived from any public utility or the exercise of any essential governmental function and accruing to any State or Territory of the United States, or to any political subdivision thereof, or to the District of Columbia, or income accruing to the Government of any possession of the United States, or any political subdivision thereof, is exempt from tax. See article 74. The income of State workmen's compensation insurance funds established by State statutes is not taxable. In the case of a public utility acquired, constructed, operated or maintained by a taxpayer under contract with any State, Territory, or political subdivision thereof, or with the District of Columbia, containing an agreement that a portion of the net earnings of such public utility shall be paid to the State, Territory, or political subdivision thereof, or the District of Columbia, the amount so paid may be deducted by the taxpayer as a necessary expense in transacting business. See section 214 (a) (1) of the statute.

ART. 85. **Compensation of State officers.**—Compensation paid its officers and employees by a State or political subdivision thereof, including fees received by notaries public commissioned by States and the commissions of receivers appointed by State courts, is not taxable. Employees of universities receiving salaries paid in part or in whole from funds available under the Smith-Lever Act of May 8, 1914, who are officers or employees of a State, are not required to return as taxable incomes the salaries so received. This is also true with respect to the Act of August 30, 1890, relating to colleges for the benefit of agriculture and the mechanic arts, and to the Act of March 2, 1887, relating to agricultural experiment stations in such colleges.

ART. 86. **Compensation of soldiers and sailors.**—A person of either sex in active service in the military or naval forces of the United States may exclude from gross income his or her compensation received from the United States up to the amount of $3,500 in any taxable year, except that this exemption does not apply to compensation received either before or after the present war. The date of the termination of the war for the purpose of the statute will be fixed by proclamation of the President. The military and naval forces of the United States include, among others, Army contract surgeons and members of the military and naval organizations named in section 1 of the statute. A person is in active service if he is actually serving in such forces, not necessarily in the field or in the theater of war, and is not merely on the retired or reserve list. Accordingly, if such a person receives compensation from the United States of $3,500 or less and has no other income of an amount sufficient in itself to require him to render a return of income, he need make no return. Members of draft boards are not as such entitled to this exemption.

ART. 87. **Income accruing prior to March 1, 1913.**—Property held by the taxpayer on March 1, 1913, is capital. Included in this capital are all claims, whether evidenced by writing or not, and all interest which had accrued thereon before that date. Interest accruing on or after that date is taxable income. Where an interest-bearing claim contracted prior to March 1, 1913, is paid in whole or in part after that date, any gain derived from the conversion of the claim into money is taxable. The amount of such gain is the excess of the proceeds of the claim (both principal and interest), exclusive of any interest accrued since February 28, 1913, already returned as income, over the fair market value of the claim as of March 1, 1913 (both principal and interest then accrued). In the case of an insurance policy its surrender value as of March 1, 1913, may be used as a basis for the purpose of ascertaining the gain derived from the sale or other disposition of such policy. Where services were rendered prior to March 1, 1913, but paid for thereafter, the amount received is taxable income to the extent of the excess of such amount over the fair market value on March 1, 1913, of the principal of the claim and any interest which had then accrued. A claim for the purpose of this article means a right existing unconditionally on March 1, 1913, and then assignable, whether presently payable or not. Interest does not, of course, include dividends on corporate stock. See section 201 of the statute and articles 1541–1549.

ART. 88. **Subtraction for redemption of trading stamps.**—Where a taxpayer, for the purpose of promoting his business, issues with sales trading stamps or premium coupons redeemable in merchandise or cash, he should in computing the income from such sales subtract only the amount received or receivable which will be required for the redemption of such part of the total issue of trading stamps or premium coupons issued during the taxable year as will eventually be presented for redemption. This amount will be determined in the light of the experience of the taxpayer in his particular business and of other users engaged in similar businesses. The taxpayer shall file for each of the five preceding years, or such number of these years as stamps or coupons have been issued by him, a statement showing (*a*) the total issue of stamps during each year, (*b*) the total stamps redeemed in each year, and (*c*) the percentage for each year of the stamps redeemed to the stamps issued in such year. A similar statement shall also be presented showing the experience of other users of stamps or coupons whose experience is relied upon by the taxpayer to determine the amount to be subtracted from the proceeds of sales. The Commissioner will examine the basis used in each return, and in any case in which the amount subtracted in respect of such stamps or coupons is found to be excessive an amended return or amended returns will be required.

GROSS INCOME DEFINED: NONRESIDENT ALIEN INDIVIDUAL.

[SEC. 213.] (c) In the case of nonresident alien individuals, gross income includes only the gross income from sources within the United States, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, dividends from resident corporations, and including all amounts received (although paid under a contract for the sale of goods or otherwise) representing profits on the manufacture and disposition of goods within the United States.

ART. 91. **Gross income of nonresident alien individuals.**—In the case of nonresident alien individuals "gross income" means only the gross income from sources within the United States. This includes interest on bonds, notes or other interest-bearing obligations of residents, corporate or otherwise, dividends from resident corporations, amounts received representing profits on the manufacture and disposition of goods within the United States, rentals and royalties from property and income from business carried on in the United States, interest on deposits in banks located within the United States, income from capital otherwise invested in the United States, and income from services rendered or labor performed within the United States. For what is a resident corporation see article 1509. As to the gross income of foreign corporations see section 233 (b) of the statute and article 550.

ART. 92. **Income of nonresident alien individuals not subject to tax.**—Salaries, wages, commissions and rents paid by domestic business enterprises to nonresident alien employees for services rendered entirely in a foreign country or for property located in a foreign country are not subject to tax as income from a source within the United States. Dividends on stock and interest on notes of corporations organized in the United States, but doing no business and owning no property therein, paid to nonresident alien individuals or corporations, are not subject to the tax. The tax does not apply to charter money or freight payments received by a foreign owner in regard to a vessel operated between the United States and foreign ports, if the person receiving the income maintains no regular agency in the United States and is not doing business in the United States. Compensation received by nonresident alien munitions inspectors and purchasing agents from foreign governments is not subject to the tax.

ART. 92(a). **When the wages of a nonresident alien seaman are derived from sources within the United States.**—While resident alien seamen are taxable like citizens on their entire income from whatever sources derived, nonresident alien seamen are taxable only on income from sources within the United States. Ordinarily, wages received for services rendered inside the territorial United States are to be regarded as from sources within the United States. The wages of an alien seaman earned on a coastwise vessel are from sources within the United States, but wages earned by an alien seaman on a ship regularly engaged in foreign trade are not to be regarded as from sources within the United States, even though the ship flies the American flag, or although during a part of the time the ship touched at United States ports and remained there a reasonable time for the transaction of its business. The presence of a seaman aboard a ship which enters a port for such purposes of foreign trade is merely transitory, and wages earned during that period by a nonresident alien seaman are not taxable. There is no withholding from the wages of alien seamen unless they are nonresidents within the rules laid down in articles 311 to 315. Even in the case of a nonresident alien seaman, the employer is not obliged to withhold from wages unless those wages are from sources within the United States as defined above. As to when alien seamen are to be regarded as residents, see article 312 (a).

ART. 93. **Income of nonresident aliens from United States bonds.**—By virtue of section 4 of the Victory Liberty Loan Act of March 3, 1919, amending section 3 of the Fourth Liberty Bond Act of July 9, 1918, the interest received on and after March 3, 1919, on bonds, notes and certificates of indebtedness of the United States and bonds of the War Finance Corporation, while beneficially owned by a nonresident alien individual, or a foreign corporation, partnership or association, not engaged in business in the United States, is exempt from all income and war profits and excess profits taxes. See article 81.

DEDUCTIONS ALLOWED: BUSINESS EXPENSES.

SEC. 214. (a) That in computing net income there shall be allowed as deductions:

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

ART. 101. **Business expenses.**—Business expenses, whether subtracted from total receipts in computing gross income or deducted from gross income in computing net income, include all items entering into what is ordinarily known as the cost of goods sold, together with selling and management expenses, except such classes of items as are treated in articles 121 to 268. Among the items to be treated as business expenses are material, labor, supplies, and repairs in the case of a manufacturer, while a merchant would include his purchases of goods bought for resale. In either case the amount to be taken as a deduction in any year should be determined by taking into consideration the inventory at the beginning and end of the year. Other items that may be included as business expenses are reasonable compensation for the services of officers and employees, advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident or other similar losses in the case of a business, and rental for the use of business property. But see article 294. A taxpayer is entitled to deduct the necessary expenses paid in carrying on his business from his gross income from whatever source. See section 215 of the statute and articles 291–294. As to deductions by corporations see section 234 and articles 561–573.

ART. 102. **Cost of materials.**—Taxpayers carrying materials and supplies on hand should include in expenses the charges for materials and supplies only to the amount that they are actually consumed and used in operation during the year for which the return is made, provided that the cost of such material and supplies has not been taken into account in determining the net income for any previous year. If a taxpayer carries materials or supplies on hand for which no record of consumption is kept or of which physical inventories at the beginning and end of the year are not taken, it will be permissible for the taxpayer to include in his expenses and deduct from gross income the total cost of such supplies and materials as were purchased during the year for which the return is made, provided the net income is clearly reflected by this method.

ART. 103. **Repairs.**—The cost of incidental repairs which neither materially add to the value of the property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted as expense, provided the plant or property account is not increased by the amount of such expenditures. Repairs in the nature of replacements, to the extent that they arrest deterioration and appreciably prolong the life of the property should be charged against the depreciation reserve. See articles 161–171.

ART. 104. **Professional expenses.**—A professional man may claim as deductions the cost of supplies used by him in the practice of his profession, expenses paid in the operation and repair of an automobile used in making professional calls, dues to professional societies and subscriptions to professional journals, the rent paid for office rooms, the expense of the fuel, light, water, telephone, etc., used in such offices, and the hire of office assistants. Amounts expended for books, furniture, and professional instruments and equipment of a permanent character are not allowable as deductions. See section 215 and articles 291–294.

ART. 105. **Compensation for personal services.**—Among the ordinary and necessary expenses paid or incurred in carrying on any trade or business may be included a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services. This test and its practical application may be further stated and illustrated as follows:

(1) Any amount paid in the form of compensation, but not in fact as the purchase price of services, is not deductible. (*a*) An ostensible salary paid by a corporation may be a distribution of a dividend on stock. This is likely to occur in the case of a corporation having few stockholders, practically all of whom draw salaries. If in such a case the salaries are based upon or bear a close relationship to the stockholdings of the officers or employees, it would seem likely that the salaries, if in excess of those ordinarily paid for similar services, are not paid wholly for services rendered, but in part as a distribution of earnings upon the stock. (*b*) An ostensible salary paid by a corporation may be in part a waste or appropriation of assets of the corporation. This may occur where salaried employees are in control of the corporation through holding directly or indirectly a majority of its stock or, in the case of a large corporation with many stockholders, owning a substantial minority of its stock, and the tendency of the officers unduly to inflate their salaries must be taken into account. (*c*) An ostensible salary may be in part payment for property. This may occur, for example, where a partnership sells out to a corporation, the former partners agreeing to continue in the service of the corporation. In such a case it may be found that the salaries of the former partners are not merely for services, but in part constitute payment for the transfer of their business.

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

individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid.

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

ART. 106. **Treatment of excessive compensation.**—As to the treatment of amounts ostensibly paid as compensation, but not allowed to be deducted as such, the following rules apply:

(1) In the case of excessive payments by corporations, if such payments correspond or bear a close relationship to stock holdings, the amount of the excess should be treated as dividends and would thus be exempt from the normal tax in the hands of the recipients; or if such payments represent an appropriation of assets of the corporation by officers who control it and fix their compensation in violation of the rights of the corporation, the amount of the excess, while disallowed as a deduction by the corporation, should be treated as compensation of the individuals subject to the normal tax, compensation so received being none the less subject to tax in all respects; or if such payments constitute in part payment for property, the amount of the excess should be treated by the corporation as a capital expenditure and by the recipient as part of the purchase price.

(2) In the case of excessive payments by individuals or partnerships, the amounts disallowed should ordinarily be treated as shares of the profits of a partnership, except that a payment for property should be treated by the individual or partnership as a capital expenditure and by the recipient as part of the purchase price.

ART. 107. **Bonuses to employees.**—Bonuses to employees will constitute allowable deductions from gross income when such payments are made in good faith and as additional compensation for the services actually rendered by the employees, provided such payments, when added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered. Donations made to employees and others, which do not have in them the element of compensation or are in excess of reasonable compensation for services, are considered gratuities and are not deductible from gross income.

ART. 108. **Pensions.**—Amounts paid for pensions to retired employees or to their families or others dependent upon them, or on account of injuries received by employees, and lump sum amounts paid as compensation for injuries, are proper deductions as ordinary and necessary expenses. Such deductions are limited to the amount not compensated for by insurance or otherwise. No deduction shall be made for contributions to a pension fund held by the corporation, the amount deductible in such case being the amount actually paid to the employee. When the amount of the salary of an officer or employee is paid for a limited period after his death to his widow or heirs in recognition of the services rendered by the individual, such payments may be deducted. Salaries paid by employers during the continuance of the war to employees who are absent in the military or naval service or are serving the Government in other ways at a nominal compensation, but who intend to return at the conclusion of the war, are allowable deductions.

Art. 109. **Rentals.**—Where a leasehold is acquired for business purposes for a specified sum, the purchaser may take as a deduction in his return an aliquot part of such sum each year, based on the number of years the lease has to run. Taxes paid by a tenant to or for a landlord for business property are additional rent and constitute a deductible item to the tenant and taxable income to the landlord, the amount of the tax being deductible by the latter. The cost borne by a lessee in erecting buildings or making permanent improvements on ground of which he is lessee is held to be a capital investment and not deductible as a business expense. In order to return to such taxpayer his investment of capital, an annual deduction may be made from gross income of an amount equal to the total cost of such improvements divided by the number of years remaining of the term of lease, and such deduction shall be in lieu of a deduction for depreciation. If the remainder of the term of lease is greater than the probable life of the buildings erected, or of the improvement made, this deduction shall take the form of an allowance for depreciation. (See article 48.)

Art. 110. **Expenses of farmers.**—A farmer who operates a farm for profit is entitled to deduct from gross income as necessary expenses all amounts actually expended in the carrying on of the business of farming. The cost of ordinary tools of short life or small cost, such as hand tools, including shovels, rakes, etc., may be included. The cost of feeding and raising live stock may be treated as an expense deduction, in so far as such cost represents actual outlay, but not including the value of farm produce grown upon the farm or the labor of the taxpayer. Where a farmer is engaged in producing crops which take more than a year from the time of planting to the process of gathering and disposal, expenses deducted may be determined upon the crop basis, and such deductions must be taken in the year in which the gross income from the crop has been realized. If a farm is operated for recreation or pleasure and not on a commercial basis, and if the expenses incurred in connection with the farm are in excess of the receipts therefrom, the entire receipts from the sale of products may be ignored in rendering a return of income, and the expenses incurred, being regarded as personal expenses, will not constitute allowable deductions. The cost of farm machinery, equipment, and farm buildings represents a capital investment and is not an allowable deduction as an item of expense. Amounts expended in the development of farms, orchards, and ranches prior to the time when the productive state is reached may be regarded as investments of capital. Amounts expended in purchasing work, breeding, or dairy animals are regarded as investments of capital, and may be depreciated unless such animals are included in an inventory in accordance with article 38. The purchase price of an automobile, even when wholly used in carrying on farming operations, is not deductible, but is regarded as an investment of capital. The cost of gasoline, repairs, and upkeep of an automobile if used wholly in the business of farming is deductible as an expense; if used partly for business purposes and partly for the pleasure or convenience of the taxpayer or his family, such cost may be apportioned according to the extent of the use for purposes of business and pleasure or convenience, and only the proportion of such cost justly attributable to business purposes is deductible as a necessary expense. See articles 38, 145, and 171.

Art. 111. **When charges deductible.**—Each year's return, so far as practicable, both as to gross income and deductions therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. See articles 21–24 and 52. The expenses, liabilities or deficit of one year can not be used to reduce the income of a subsequent year. A person making returns on an accrual basis has the right to deduct all authorized allowances, whether paid in cash or set up as a liability, and it follows that if he does not within any year pay or accrue certain of his expenses, interest, taxes or other charges, and makes no deduction therefor, he can not deduct from the income of the next or any subsequent year any amounts then paid in liquidation of the previous year's liabilities. A loss from theft or embezzlement occurring in one year and discovered in another is deductible only for the year of its occurrence. Any amount paid pursuant to a judgment or otherwise on account of damages for personal injuries, patent infringement or otherwise, is deductible from gross income when the claim is put in judgment or paid, less any amount of such damages as may have been compensated for by insurance or otherwise. If subsequently to its occurrence, however, a taxpayer first ascertains the amount of a loss sustained during a prior taxable year which has not been deducted from gross income, he may render an amended return for such preceding taxable year, including such amount of loss in the deductions from gross income, and may file a claim for refund of the excess tax paid by reason of the failure to deduct such loss in the original return. See section 252 of the statute and articles 1031–1038.

DEDUCTIONS ALLOWED: INTEREST.

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

(2) All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917), the interest upon which is wholly exempt from taxation under this title as income to the taxpayer, or, in the case of a nonresident alien individual, the proportion of such interest which the amount of his gross income from sources within the United States bears to the amount of his gross income from all sources within and without the United States; * * *

ART. 121. **Interest.**—Interest paid or accrued within the year on indebtedness may be deducted from gross income, except that interest on indebtedness incurred or continued to purchase or carry securities, such as municipal bonds, the interest upon which is exempt from tax, is not deductible. However, this exception does not apply to obligations of the United States issued after September 24, 1917, which include the Liberty bonds of the second and subsequent issues and Victory notes, and interest on indebtedness incurred to purchase such obligations is deductible pursuant to the general rule. See articles 77–80 (a). Interest paid by the taxpayer on a mortgage upon real estate of which he is the legal or equitable owner, even though the taxpayer is not directly liable upon the bond or note secured by such mortgage, may be deducted as interest on his indebtedness. Payments made for Maryland or Pennsylvania ground rents are not deductible as interest.

ART. 122. **Interest on capital.**—Interest calculated as being a charge against income on account of capital or surplus invested in the business, but which does not represent a payment on an interest-bearing obligation, is not an allowable deduction from gross income; that is to say, the interest which the money might earn if otherwise invested is not a deductible charge against income.

DEDUCTIONS ALLOWED: TAXES.

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

(3) Taxes paid or accrued within the taxable year imposed (a) by the authority of the United States, except income, war-profits and excess-profits taxes; or (b) by the authority of any of its possessions, except the amount of income, war-profits and excess-profits taxes al-

lowed as a credit under section 222; or (c) by the authority of any State or Territory, or any county, school district, municipality, or other taxing subdivision of any State or Territory, not including those assessed against local benefits of a kind tending to increase the value of the property assessed; or (d) in the case of a citizen or resident of the United States, by the authority of any foreign country, except the amount of income, war-profits and excess-profits taxes allowed as a credit under section 222; or (e) in the case of a nonresident alien individual, by the authority of any foreign country (except income, war-profits and excess-profits taxes, and taxes assessed against local benefits of a kind tending to increase the value of the property assessed), upon property or business; * * *

ART. 131. **Taxes.**—Federal taxes (except income, war profits, and excess profits taxes), State and local taxes (except taxes assessed against local benefits of a kind tending to increase the value of the property assessed), and taxes imposed by possessions of the United States or by foreign countries (except the amount of income, war profits, and excess profits taxes allowed as a credit against the tax), are deductible from gross income. See section 222 of the statute and articles 381–385 as to tax credits. Postage is not a tax. Amounts paid to States under secured debts laws in order to render securities tax exempt are deductible. Automobile license fees are ordinarily taxes.

ART. 132. **Federal duties and excise taxes.**—Import or tariff duties paid to the proper customs officers, and business, license, privilege, excise, and stamp taxes paid to internal revenue collectors, are deductible as taxes imposed by the authority of the United States, provided they are not added to and made a part of the expenses of the business or the cost of articles of merchandise with respect to which they are paid, in which case they can not be separately deducted.

ART. 133. **Taxes for local benefits.**—So-called taxes, more properly assessments, paid for local benefits, such as street, sidewalk, and other like improvements, imposed because of and measured by some benefit inuring directly to the property against which the assessment is levied, do not constitute an allowable deduction from gross income. A tax is considered assessed against local benefits when the property subject to the tax is limited to property benefited. Special assessments are not deductible, even though an incidental benefit may inure to the public welfare. The taxes deductible are those levied for the general public welfare by the proper taxing authorities at a like rate against all property in the territory over which such authorities have jurisdiction. Assessments under the statutes of California relating to irrigation and of Iowa relating to drainage, and under certain statutes of Tennessee relating to levees, are limited to property benefited, and when it is clear that the assessments are so limited, the amounts paid thereunder are not deductible as taxes. When assessments are made for the purpose of maintenance or repair of local benefits, the taxpayer may deduct the assessments paid as an expense incurred in business, if the payment of such assessments is necessary to the conduct of his business. When the assessments are made for the purpose of constructing local benefits, the payments by the taxpayer are in the nature of capital expenditures and are not deductible. Where assessments are made for the purpose of both construction and maintenance or repairs, the burden is on the taxpayer to show the allocation of the amounts assessed to the different purposes. If the allocation can not be made, none of the amounts so paid is deductible.

Art. 134. **Inheritance taxes.**—State inheritance taxes paid by the executor or administrator of an estate of a deceased person, which are provided by law to be deducted from the respective legacies or distributive shares, are not allowable deductions in computing the net income of such estate subject to tax, even though the will contains a direction to pay inheritance taxes out of the residue. An inheritance tax is upon the transfer of the property and not upon the estate of the decedent or upon the executor or administrator, although the latter is required to pay it. In general, taxes paid or accrued within the year imposed by the authority of any State, or otherwise, are limited to those imposed upon the taxpayer and do not include taxes paid by him on behalf of another, even though he is required by law to make such payment. See articles 565 and 566. Since, moreover, the tax is imposed upon the transfer before the property reaches the legatee or distributee, and merely diminishes the capital share of the estate received by him, such tax is not imposed upon the legatee or distributee and is not an allowable deduction from his income. Similarly, Federal estate taxes are not deductible.

DEDUCTIONS ALLOWED: LOSSES.

[Sec. 214. (a) That in computing net income there shall be allowed as deductions:]

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

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; but in the case of a nonresident alien individual only as to such transactions within the United States;

(6) Losses sustained during the taxable year of property not connected with the trade or business (but in the case of a nonresident alien individual only property within the United States) if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insurance or otherwise; * * *

ART. 141. **Losses.**—Losses sustained during the taxable year and not compensated for by insurance or otherwise are fully deductible (except by nonresident aliens) if (*a*) incurred in the taxpayer's trade or business, or (*b*) incurred in any transaction entered into for profit, or (*c*) arising from fires, storms, shipwreck or other casualty, or from theft. They must usually be evidenced by closed and completed transactions. In the case of the sale of assets the loss will be the difference between the cost thereof, less depreciation sustained since acquisition, or the fair market value as of March 1, 1913, if acquired before that date, less depreciation since sustained, and the price at which they were disposed of. See section 202 of the statute and articles 39–46 and 1561. When the loss is claimed through the destruction of property by fire, flood or other casualty, the amount deductible will be the difference between the cost of the property or its fair market value as of March 1, 1913, if acquired before that date, and the salvage value thereof, after deducting from such cost or such value as of March 1, 1913, the amount, if any, which has been or should have been set aside and deducted in the current year and previous years from gross income on account of depreciation and which has not been paid out in making good the depreciation sustained. But the loss should be reduced by the amount of any insurance or other compensation received. See articles 49 and 50. A loss in the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit. Losses in illegal transactions are not deductible. Where a person gives away property, or is divested thereof by death, no realization of loss results therefrom.

ART. 142. **Voluntary removal of buildings.**—Loss due to the voluntary removal or demolition of old buildings, the scrapping of old machinery, equipment, etc., incident to renewals and replacements will be deductible from gross income in a sum representing the difference between the cost of such property demolished or scrapped and the amount of a reasonable allowance for the depreciation which the property had undergone prior to its demolition or scrapping; that is to say, the deductible loss is only so much of the original cost of the property, less salvage, as would have remained unextinguished had a reasonable allowance been charged off for depreciation during each year prior to its destruction. When a taxpayer buys real estate upon which is located a building which he proceeds to raze with a view to erecting thereon another building, it will be considered that the taxpayer has sustained no deductible loss by reason of the demolition of the old building, and no deductible expense on account of the cost of such removal, the value of the real estate, exclusive of old improvements, being presumably equal to the purchase price of the land and building plus the cost of removing the useless building.

ART. 143. **Loss of useful value.**—When through some change in business conditions the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in the business, he may claim as a loss for the year in which he takes such action the difference between the cost or the fair market value as of March 1, 1913, of any asset so discarded (less any depreciation sustained) and its salvage value remaining. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property must be prematurely discarded, as, for example, where an increase in the cost of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. But see articles 181–189.

ART. 144. **Shrinkage in securities and stocks.**—A person possessing securities, such as stocks and bonds, can not deduct from gross income any amount claimed as a loss on account of the shrinkage in value of such securities through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the securities mature or are disposed of. See, however, article 154. In the case of banks or other corporations which are subject to supervision by State or Federal authorities, and which in obedience to the orders of such supervisory officers charge off as losses amounts representing an alleged shrinkage in the value of property, the amounts so charged off do not constitute allowable deductions. The foregoing applies only to owners and investors, and not to dealers in securities, as to whom see article 1585. However, if stock of a corporation becomes worthless, its cost or its fair market value as of March 1, 1913, if acquired prior thereto, may be deducted by the owner in the taxable year in which the stock became worthless, provided a satisfactory showing of its worthlessness be made as in the case of bad debts. See article 151.

ART. 145. **Losses of farmers.**—Losses incurred in the operation of farms as business enterprises are deductible from gross income. If farm products are held for favorable markets, no deduction on account of shrinkage in weight or physical value or by reason of deterioration in storage shall be allowed, except as such shrinkage may be reflected in an inventory if used to determine profits. The total loss by frost, storm, flood, or fire of a prospective crop is not a deductible loss in computing net income. A farmer engaged in raising and selling stock, cattle, sheep, horses, etc., is not entitled to claim as a loss the value of animals that perish from among those animals that were raised on the farm, except as such loss is reflected in an inventory if used. If live stock has been purchased for any purpose, and afterwards dies from disease, exposure, or injury, or is killed by order of the authorities of a State or the United States, the actual purchase price of such stock, less any depreciation which may have been previously sustained with respect to such perished live stock, and less also any insurance or indemnity recovered, may be deducted as a loss. The actual cost of other property, less depreciation already sustained, destroyed by order of the authorities of a State or of the United States, may in like manner be claimed as a loss; but if reimbursement is made by a State or the United States in whole or in part on account of stock killed or property destroyed, the amount received shall be reported as income for the year in which reimbursement is made. The cost of any feed, pasturage, or care which has been deducted as an expense of operation shall not be included as part of the cost of the stock for the purpose of ascertaining the amount of a deductible loss. If gross income is ascertained by inventories, no deduction can be made for live stock or products lost during the year, whether purchased for resale or produced on the farm, as such losses will be reflected in the inventory by reducing the amount of live stock or products on hand at the close of the year. If an individual owns and operates a farm, in addition to being engaged in another trade, business, or calling, and sustains a loss from such operation of the farm, then the amount of loss sustained may be deducted from gross income received from all sources, provided the farm is not operated for recreation or pleasure. See articles 38, 110, and 171.

DEDUCTIONS ALLOWED: BAD DEBTS.

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

(7) Debts ascertained to be worthless and charged off within the taxable year; * * *

ART. 151. **Bad debts.**—An account merely written down or a debt recognized as worthless prior to the beginning of the taxable year is not deductible. Where all the surrounding and attendant circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction. Bankruptcy may or may not be an indication of the worthlessness of a debt, and actual determination of worthlessness in such a case is sometimes possible before and at other times only when a settlement in bankruptcy shall have been had. Where a taxpayer ascertained a debt to be worthless and charged it off in one year, the mere fact that bankruptcy proceedings instituted against the debtor are terminated in a later year confirming the conclusion that the debt is worthless will not authorize shifting the deduction to such later year. In the case of debts existing prior to March 1, 1913, only their value on that date may be deducted upon subsequently ascertaining them to be worthless. See article 52. If a taxpayer computes his income upon the basis of valuing his notes or accounts receivable at their fair market value when received, which may be less than their face value, the amount deductible for bad debts in any case is limited to such original valuation.

ART. 152. **Examples of bad debts.**—Worthless debts arising from unpaid wages, salaries, rents, and similar items of taxable income will not be allowed as a deduction unless the income such items represent has been included in the return of income for the year in which the deduction as a bad debt is sought to be made or in a previous year. Only the difference between the amount received in distribution of the assets of a bankrupt and the amount of the claim may be deducted as a bad debt. The difference between the amount received by a creditor of a decedent in distribution of the assets of the decedent's estate and the amount of his claim may be considered a worthless debt. A purchaser of accounts receivable which can not be collected and are consequently charged off the books as bad debts is entitled to deduct them, the amount of deduction to be based upon the price he paid for them and not upon their face value.

ART. 153. **Worthless mortgage debt.**—Where under foreclosure a mortgagee buys in the mortgaged property and credits the indebtedness with the purchase price, the difference between the purchase price and the indebtedness will not be allowable as a deduction for a bad debt, for the property which was security for the debt stands in the place of the debt. The determination of loss in such a situation is deferred until the property is disposed of, except where a purchase money mortgage is foreclosed by the vendor of the property. See article 46. Only where a purchaser for less than the debt is another than the mortgagee may the difference between the debt and the net proceeds from the sale be deducted as a bad debt by the mortgagee.

ART. 154. **Worthless securities.**—Where bonds purchased before March 1, 1913, depreciated in value between the date of purchase and that date, and were in a later year ascertained to be worthless and charged off, the owner is entitled to a deduction in that year equal to the value of the bonds on March 1, 1913. Bonds purchased since February 28, 1913, when ascertained to be worthless, may be treated as bad debts to the amount actually paid for them. Bonds of an insolvent corporation secured only by a mortgage from which on foreclosure nothing is realized for the bondholders are regarded as ascertained to be worthless not later than the year of the foreclosure sale, and no deduction for a bad debt is allowable in computing a bondholder's income for a subsequent year. To authorize a deduction for a bad debt on account of notes held prior to March 1, 1913, their value on that date must be established. See article 144.

DEDUCTIONS ALLOWED: DEPRECIATION.

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

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

ART. 161. **Depreciation.**—A reasonable allowance for the exhaustion, wear and tear and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear or obsolescence. The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a consistent plan by which the aggregate of such amounts for the useful life of the property in the business will suffice, with the salvage value, at the end of such useful life to provide in place of the property its cost, or its value as of March 1, 1913, if acquired by the taxpayer before that date. See further articles 839 and 844.

ART. 162. **Depreciable property.**—The necessity for a depreciation allowance arises from the fact that certain property used in the business gradually approaches a point where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art, as where machinery or other property must be replaced by a new invention, or due to the property becoming inadequate to the growing needs of the business. It does not apply to inventories or to stock in trade;

nor to land apart from the improvements or physical development added to it. It does not apply to bodies of minerals which through the process of removal suffer depletion, other provision for this being made in the statute. See articles 201–237. Property kept in repair may, nevertheless, be the subject of a depreciation allowance. See article 103. The deduction of an allowance for depreciation is limited to property used in the taxpayer's trade or business. No such allowance may be made in respect of automobiles or other vehicles used chiefly for pleasure, a building used by the taxpayer solely as his residence, nor in respect of furniture or furnishings therein, personal effects, or clothing; but properties and costumes used exclusively in a business, such as a theatrical business, may be the subject of a depreciation allowance.

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

ART. 164. **Capital sum recoverable through depreciation allowances.**— The capital sum to be replaced by depreciation allowances is the cost of the property in respect of which the allowance is made, except that in the case of property acquired by the taxpayer prior to March 1, 1913, the capital sum to be replaced is the fair market value of the property as of that date. In the absence of proof to the contrary, it will be assumed that such value as of March 1, 1913, is the cost of the property less depreciation up to that date. To this sum should be added from time to time the cost of improvements, additions, and betterments, the cost of which is not deducted as an expense in the taxpayer's return, and from it should be deducted from time to time the amount of any definite loss or damage sustained by the property through casualty, as distinguished from the gradual exhaustion of its utility which is the basis of the depreciation allowance. In the case of the acquisition on or after March 1, 1913, of a combination of depreciable and nondepreciable property for a lump price, as, for example, land and buildings, the capital sum to be replaced is limited to that part of the lump price which represents the value of the depreciable property at the time of such acquisition.

Where the lessee of real property erects buildings, or makes permanent improvements which become part of the realty and income or loss has been returned by the lessor as a result thereof, as provided in article 48, the capital sum to be replaced by depreciation allowances is held to be the same as though no such buildings had been erected or such improvements made.

ART. 165. **Method of computing depreciation allowance.**—The capital sum to be replaced should be charged off over the useful life of the property either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and should be described in the return.

ART. 166. **Modification of method of computing depreciation.**—If it develops that the useful life of the property has been underestimated, the plan of computing depreciation should be modified and the balance of the cost of the property, or its fair market value as of March 1, 1913, not already provided for through a depreciation reserve or deducted from book value, should be spread over the estimated remaining life of the property. Inasmuch as under the provisions of the income tax acts in effect prior to Revenue Act of 1918 deductions for obsolescence of property were not allowed except as a loss for the year in which the property was sold or permanently abandoned, a taxpayer may for 1918 and subsequent years revise the estimate of the useful life of any property so as to allow for such future obsolescence as may be expected from experience to result from the normal progress of the art. No modification of the method should be made on account of changes in the market value of the property from time to time, such as, on the one hand, loss in rental value of the buildings due to deterioration of the neighborhood, or, on the other, appreciation due to increased demand. The conditions affecting such market values should be taken into consideration only so far as they affect the estimated useful life of the property.

ART. 167. **Depreciation of patent or copyright.**—In computing a depreciation allowance in the case of a patent or copyright, the capital sum to be replaced is the cost (not already deducted as current expense) of the patent or copyright or its fair market value as of March 1, 1913, if acquired prior thereto. The allowance should be computed by an apportionment of the cost of the patent or copyright or of its fair market value as of March 1, 1913, over the life of the patent or copyright since its grant, or since its acquisition by the taxpayer, or since March 1, 1913, as the case may be. If the patent or copyright was acquired from the Government, its cost consists of the various Government fees, cost of drawings, experimental models, attorney's fees, etc., actually paid. If a corporation purchased a patent and paid for it in stock or securities, its cost is the fair market value of the stock or securities at the time of the purchase. Depreciation of a patent can be taken on the basis of the fair market value as of March 1, 1913, only when affirmative and satisfactory evidence of such value is offered. Such evidence should whenever practicable be submitted with the return. If the patent becomes obsolete prior to its expiration such proportion of the amount on which its depreciation may be based as the number of years of its remaining life bears to the whole number of years intervening between the date when it was acquired and the date when it legally expires may be deducted, if permission so to do is specifically secured from the Commissioner. Owing to the difficulty of allocating to a particular year the obsolescence of a patent, such permission will be granted only if affirmative and satisfactory evidence that the obsolescence occurred in the year for which the return is made is submitted to the Commissioner. The fact that depreciation has not been taken in prior years does not entitle the taxpayer to deduct in any taxable year a greater amount for depreciation than would otherwise be allowable. See articles 40 and 843.

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

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

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

ART. 171. **Depreciation in the case of farmers.**—A reasonable allowance for depreciation may be claimed on farm buildings (other than a dwelling occupied by the owner), farm machinery, and other physical property. A reasonable allowance for depreciation may also be claimed on live stock acquired for work, breeding, or dairy purposes, unless they are included in an inventory used to determine profits in accordance with article 38. Such depreciation should be based on the cost and the estimated life of the live stock. If such live stock be included in an inventory no depreciation thereof will be allowed, as the corresponding reduction in their value will be reflected in the inventory. See also articles 38, 110, and 145.

DEDUCTIONS ALLOWED: AMORTIZATION.

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

(9) In the case of buildings, machinery, equipment, or other facilities, constructed, erected, installed, or acquired, on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war, and in the case of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of the present war, there shall be allowed a reasonable deduction for the amortization of such part of the cost of such facilities or vessels as has been borne by the taxpayer, but not again including any amount otherwise allowed under this title or previous Acts of Congress as a deduction in computing net income. At any time within three years after the termination of the present war, the Commissioner may, and at the request of the taxpayer shall, reexamine the return, and if he then finds as a result of an appraisal or from other evidence that the deduction originally allowed was incorrect, the taxes imposed by this title and by Title III for the year or years affected

shall be redetermined; and the amount of tax due upon such redetermination, if any, shall be paid upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 252; * * *

ART. 181. **Scope of provision for amortization.**—All allowances made to a taxpayer by a contracting department of the Government, or by any other contractor, for amortization or fall in the value of property, whether such allowances were made as a part of the price of the product or in settlement of claims arising out of the cancellation or termination of contracts, shall be included in gross income. All payments arising out of the settlement of such claims shall be included in the accrued income of the taxable year in which such cancellation or termination (whether formal or informal) occurred. The amount of amortization to be allowed as a deduction from gross income, for the purpose of the tax, shall be computed in accordance with the provisions of articles 181 to 189, pursuant to which the deduction must be made, and not upon the basis of any amounts contractually or otherwise determined.

ART. 182. **Depreciation of amortized property.**—The allowance for amortization shall be inclusive of all depreciation during the amortization period on property subject to amortization. (See art. 186.) Depreciation will be allowed, beginning at the close of the amortization period, upon property the cost of which has been partly amortized. Depreciation on partly amortized property shall be based on the value of such property after the amortization allowance has been deducted. Property which has been amortized to its scrap value shall not further be subject to depreciation.

ART. 183. **Property cost of which may be amortized.**—The taxpayer may deduct from gross income a reasonable allowance for amortization; such deduction not to be in excess of the cost of buildings, machinery, equipment or other facilities constructed, erected, installed, or acquired on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war, or of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of the present war.

In the case of property the construction, erection, installation, or acquisition of which was commenced before April 6, 1917, and completed subsequent to that date, amortization will be allowed with respect only to that part of the cost incurred on or after April 6, 1917, and which was properly entered on the books of the taxpayer on or after that date.

ART. 184. **Cost which may be amortized.**—The total amount subject to amortization shall be the difference between the original cost of the property if constructed, erected, installed, or acquired on or after April 6, 1917; or if acquired partly before and partly after April 6, 1917, then that part of the cost incurred on or after April 6, 1917, and properly entered on the books of the taxpayer on or after that date, less any amounts deducted for depreciation, losses, etc., prior to January 1, 1918, and the value of the property on either of the bases indicated below:

(1) In the case of property useful to the taxpayer only during the period of its operation as a war facility and which has been sold or permanently discarded, or which will be sold or permanently discarded within three years after the termination of the war; the value shall be the actual sale price or estimated fair market value as of the date when the property was or will be permanently discarded, such fair market value to be reestablished at and as of the time of the investigation by engineers of the Bureau of Internal Revenue.

(2) In the case of property not included in (1) above, the value shall be the estimated value to the taxpayer in terms of its actual use or employment in his going business; such value to be not less than the sale or salvage value of the property: *Provided, however*, That for the purposes of returns made in 1919, the preliminary estimate of the amount of such amortization shall not, in any case, have exceeded 25 per cent of the cost of the property. In the determination, by engineers of the Bureau of Internal Revenue, of the proper amortization allowance, the estimated value to the taxpayer of the property in terms of its actual use or employment in his going business, shall be as of the time of such determination. In the final determination, the amount of the amortization allowance will be ascertained upon the basis of stable post-war conditions under regulations to be promulgated when these conditions become apparent.

Special record of all property falling in (1) above, must be preserved by the taxpayer, and the Commissioner must be promptly notified (*a*) if, after having been in good faith permanently discarded or dismantled, property shall in any case be restored to use because of conditions not foreseen or anticipated at the time it was discarded; or (*b*) of the selling price, if sold.

ART. 185. **Amortization period.**—The amortization allowance shall be spread in proportion to the net income (computed without benefit of the amortization allowance) between January 1, 1918 (or if the property was acquired subsequent to that date, January 1st of the year in which acquired) and either of the following dates:

(*a*) If the claim is based on (1) of article 184, the date when the property was or will be sold or permanently discarded as a war facility; or (*b*) if the claim is based on (2) of article 184, the actual or estimated date of cessation of operation as a war facility.

All taxpayers claiming an allowance for amortization shall compute (or, to the extent that accurate computations can not be made, shall estimate) the amount of their net income for the period between January 1, 1918, and the dates specified above, and shall also compute (or estimate as above) that part thereof properly assignable to each of the calendar years falling within the amortization period; and the amount of income so computed or estimated shall be the basis for apportioning the amounts of amortization applicable to each of the calendar years affected. Taxpayers reporting on the fiscal year basis shall (*a*) in all computations based upon 1918 rates for fiscal years ending in 1918 and 1919, use the amount of such allowance apportioned to the calendar year 1918; (*b*) in all computations based upon 1919 rates for a year beginning in 1918 and ending in 1919, use the amount of such allowance apportioned to the calendar year 1919; and (*c*) in all computations for subsequent fiscal years, use the number of twelfths of the allowance apportioned to each calendar year falling within such fiscal year that there are months of such calendar year falling within such fiscal year.

ART. 186. **Additional requirements for amortization.**—Claims for amortization must be unmistakably differentiated in the return from all other claims for wear, tear, obsolescence and loss. No such claim will be allowed unless it is reflected in any accounts submitted by the taxpayer to stockholders and in any credit statements by the taxpayer to banks, and is given full effect on his financial books of account. If Government or other contracts taken by the taxpayer contained recognition of amortization as an element in the cost of production, copies of such contracts shall be filed with the taxpayer's return, together with a statement and description of any sums received on account of amortization and the basis upon which they were determined. In any case in which an allowance has been made for amortization of cost the taxpayer will not be allowed to restore to his invested capital for the purpose of the war profits and excess profits tax any portion of the amount covered by such allowance.

ART. 187. **Redetermination of amortization allowance.**—A redetermination of the deduction allowed on account of amortization may, or at the request of the taxpayer shall, be made by the Commissioner at any time within three years after the termination of the present war, and if as a result of an appraisal or from other evidence it is found that the deduction originally allowed was incorrect, the amount of tax due for each taxable year during the amortization period will be adjusted by additional assessment or by refund.

ART. 188. **Sale of amortized property.**—In the case of the bona fide sale of amortized property before three years from the termination of the war, the sale price thereof will be considered as reflecting the correctness or incorrectness of the amortization allowance made, due allowance being made for depreciation sustained since the close of the amortization period.

ART. 189. **Information to be furnished by the taxpayer.**—The taxpayer's claim for amortization must be complete and comprehensive in all respects. The Commissioner will not entertain claims which do not clearly set forth full data with respect to the property which it is desired to amortize.

To assist the taxpayer in compiling this information the Commissioner has prepared Guide Form 1007–M, which explains in detail the manner in which claims for amortization should be presented. A copy of this guide form will be furnished to the taxpayer upon application to the Commissioner.

DEDUCTIONS ALLOWED: DEPLETION.

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

(10) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided,* That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further,* That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee; * * *

ART. 201. **Depletion of mines, oil and gas wells; depreciation of improvements.**—Sections 214 (a) (10) and 234 (a) (9) provide that taxpayers shall be allowed as a deduction in computing net income in the case of natural deposits a reasonable allowance for depletion of mineral and for depreciation of improvements. The provisions of the statute and these articles do not apply to or affect the regulations covering invested capital, losses, accounting methods, etc.

The essence of these provisions of the statute is that the owner of mineral deposits, whether freehold or leasehold, shall within the limitations prescribed, secure through an aggregate of annual depletion and depreciation deductions the return of either (*a*) his capital invested in the property, or (*b*) the value of his property on the basic date, plus subsequent allowable capital additions (see article 222), but not including land values for purposes other than the extraction of minerals.

Operating owners, lessors, and lessees, whether corporations or individuals, are entitled to deduct an allowance for depletion and depreciation, but a stockholder in a mining or oil or gas corporation is not allowed such deductions. (See further articles 839 and 844.)

When used in these articles of the regulations covering depletion and depreciation—

(*a*) The term "basic date" indicates the date of valuation, i. e., March 1, 1913, in the case of property acquired prior thereto, the date of acquisition in the case of property acquired on or after March 1, 1913, or the date of discovery, or within 30 days thereafter, in the case of discovery.

(*b*) The "fair market value" of a property is that amount which would induce a willing seller to sell and a willing buyer to purchase. Where there has been no sale and the fair market value at the basic date is to be used, such value will be determined by the method which a prospective vendor and vendee in the industry would use in arriving at the sale value of the property at the basic date.

(*c*) A "mineral property" or "property" is the oil or gas well, including the mineral, plant, development, and surface value of the land. The value of a mineral property is the combined value of its component parts.

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

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

(*f*) "Operating profit" is the net income from mineral production before depletion and depreciation are deducted. It is distinct from net income.

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

ART. 203. **Capital recoverable through depletion deductions in the case of lessee.**—(*a*) In the case of a lessee, the capital remaining in any year recoverable through depletion and depreciation deductions is (1) the value as of the basic date of the lessee's equity in the property plus (2) subsequent allowable capital additions but minus (3) depletion and depreciation sustained, whether legally allowable or not, from the basic date to the taxable year. The capital recoverable through depletion is the total capital remaining less the sum recoverable through depreciation.

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

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

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

(*e*) The value of a lessee's equity in a discovery on or after March 1, 1913, is the fair market value at date of discovery or within 30 days thereafter, of his equity in the mineral discovered.

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

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

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

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

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

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

(*g*) The value of a lessor's equity in a discovery on or after March 1, 1913, is the fair market value at the date of discovery, or within 30 days thereafter, of his equity in the mineral discovered.

ART. 205. **Determination of cost of deposits.**—In any case in which a depletion or depreciation deduction is computed on the basis of the cost or price at which any mine, mineral deposit, mineral right or leasehold was acquired, the owner or lessee will be required to show that the cost or price at which the property was bought was fixed for the purpose of a *bona fide* purchase and sale, by which the property passed to an owner in fact as well as in form other than the vendor. No fictitious or inflated cost or price will be permitted to form the basis of any calculation of a depletion or depreciation deduction, and in determining whether or not the price or cost at which any purchase or sale was made represented the actual market value of the property sold, due weight will be given to the relationship or connection existing between the person selling the property and the buyer thereof.

ART. 206. **Determination of fair market value of mineral property.**—(*a*) Where the fair market value of the property at a specified date in lieu of the cost thereof is the basis for depletion and depreciation deductions, such value must be determined, subject to approval or revision by the Commissioner, by the owner of the property in the light of the conditions and circumstances known at that date, regardless of later discoveries or developments in the property or subsequent improvements in methods of extraction and treatment of the mineral product. The value sought should be that established assuming a transfer between a willing seller and a willing buyer as of that particular date. The Commissioner will lend due weight and consideration to any and all factors and evidence having a bearing on the market value, such as cost, actual sales and transfers of similar properties, market value of stock or shares, royalties and rentals, value fixed by the owner for purpose of the capital-stock tax, valuation for local or State taxation, partnership accountings, records of litigation in which the value of the property was in question, the amount at which the property may have been inventoried in probate court, disinterested appraisals by approved methods such as the present value method and other factors.

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

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

(*d*) Mineral deposits of different grades, locations, and probable dates of extraction in a mineral property shall be valued separately. The mineral content of a deposit should be determined in accordance with article 208 in the case of mines, with article 209 in the case of oil wells, and with articles 211 and 212 in the case of gas wells. In estimating the average grade of the developed and prospective mineral, account should be taken of probable increases or decreases as indicated by the operating history. The rate of exhaustion of a mineral deposit should be determined with due regard to the limitations imposed by plant capacity, by the character of the deposit, by the ability to market the mineral product, by labor conditions, and by the operating program in force or definitely adopted at the basic date for future operations. The operating life of a mineral deposit is that number of years necessary for the exhaustion of both the developed and prospective mineral content at the rate determined as above. The operating cost comprises all current expense of producing, preparing, and marketing the mineral product sold, exclusive of Federal income, war profits, and excess profits taxes, allowable capital additions as defined in article 222, and deductions for depreciation and depletion, but including cost of repairs and replacements necessary to maintain the plant and equipment at its rated capacity and efficiency. This cost of repairs and replacements is not to be confused with the depreciation deduction by which the cost or value of plant and equipment is returned to the taxpayer free from tax. In general no estimates of these factors will be approved by the Commissioner which are not supported by the operating experience of the property or which are derived from different and arbitrarily selected periods.

(*e*) The product of the number of units of mineral recoverable in marketable form by the difference between the selling price and the operating cost per unit is the total expected operating profit. The value of each mineral deposit is then the total expected operating profit from that deposit reduced to a present value as of the basic date at the rate of interest commensurate with the risk for the operating life, and further reduced by the value at the basic date of the depreciable assets and of the capital additions, if any, necessary to realize the profits.

ART. 207. **Revaluation of mineral deposits not allowed.**—No revaluation of a property whose value as of the basic date has been determined and approved will be allowed during the continuance of the ownership under which the value was so determined and approved except in the case of discovery as defined in articles 219 and 220. The value as of the basic date may, however, be corrected when a virtual change of ownership of part of the property results as the outcome of litigation, and may be redistributed (*a*) when a revision of the number of units of mineral in the property has been made in accordance with articles 208, 209, or 211, and (*b*) in case of the sale of a part of the property, between the part sold and part retained.

ART. 208. **Determination of mineral contents of mine.**—Every taxpayer claiming a deduction for depletion for a given year will be required to estimate or determine with respect to each separate property the total units (tons, pounds, ounces, or other measure) of mineral products reasonably known or on good evidence believed to have existed in the ground on the basic date, according to the method current in the industry and in the light of the most accurate and reliable information obtainable. Preference shall be given in the selection of a unit of estimate to the principal unit (or units) paid for in the product marketed. The estimate of the recoverable units of the mineral products in the property for the purposes of valuation and depletion shall include as to both quantity and grade (*a*) the ores and minerals "in sight," "blocked out," "developed," or "assured," in the usual or conventional meaning of these terms in respect to the type of the deposit, and (*b*) "probable" or "prospective" ores and minerals (in the corresponding sense); that is, ores and minerals that are believed to exist on the basis of good evidence although not actually known to occur on the basis of existing development; but "probable" or "prospective" ores and minerals may be computed, for purposes of this valuation, (*c*) as to quantity, only in case they are extensions of known deposits or are new bodies or masses whose existence is indicated by geological or other evidence to a high degree of probability, and (*d*) as to grade, of such richness only as accords with the best indications available. If subsequent developments show a material error in the original estimate, a new estimate may be made and the capital remaining to be recovered distributed accordingly.

ART. 209. **Determination of quantity of oil in ground.**—In the case of either an owner or lessee it will be required that an estimate, subject to the approval of the Commissioner, shall be made of the probable recoverable oil contained in the territory with respect to which the investment is made as of the time of purchase, or as of March 1, 1913, if acquired prior to that date, or within 30 days after the date of discovery, as the case may be. The oil reserves must be estimated for all undeveloped proven land as well as producing land. If information subsequently obtained clearly shows the estimate to have been materially erroneous, it may be revised with the approval of the Commissioner.

ART. 210. **Computation of deduction for depletion of mineral deposits.**—(*a*) Depletion attaches to the annual production "according to the peculiar conditions of each case" and when the depletion actually sustained, whether legally allowable or not, from the basic date, equals the cost or value on the basic date plus subsequent allowable capital additions, no further deduction for depletion will be allowed except in consequence of added value arising through discovery or purchase. (See articles 202, 203, 204, and 222.)

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

ART. 211. **Computation of allowance for depletion of gas wells.**—On account of the peculiar conditions surrounding the production of natural gas it will be necessary to compute the depletion allowance for gas properties by methods suitable to the particular cases in question and acceptable to the Commissioner. Usually the depletion of natural gas properties should be computed on the basis of decline in closed or rock pressure, taking into account the effects of water encroachment and any other modifying factors. The gas producer will be expected to compute the depletion as accurately as possible and submit with his return a description of the method by which the computation was made. The following formula, in which the units of gas are pounds per square inch of closed pressure, is recommended: The quotient of the capital account recoverable through depletion allowances to the end of the taxable year divided by the sum of the pressures at the beginning of the year plus the sum of initial pressures of new wells and less the sum of the pressures at the time of expected abandonment (which quotient is the unit cost) multiplied by the sum of the pressures at the beginning of the taxable year plus the sum of the initial pressures of new wells and less the sum of the pressures at the end of the tax year equals the depletion allowance.

ART. 212. **Gas well pressure records to be kept.**—Beginning with 1919 closed pressure readings of representative wells, if not of all wells, must be carefully made and kept. In order to standardize pressure readings the well should remain closed until the pressure does not build up more than 1 per cent of the total pressure in ten minutes. Ordinarily 24 hours will suffice for this purpose, but some wells will need to remain closed for a longer period. If there is any water in the well it should be blown or pumped off before the well is closed. A closed pressure reading of a gas well which has been producing, or is near gas wells that have been producing, is lower than the actual pressure of the gas in the reservoir by an amount depending on the well's location with reference to other producing wells and the length of time it has been closed in. It is necessary to record the length of time the well has been closed and to show how the pressure built up during this period. Successive readings will indicate the point at which the pressure becomes approximately stationary, that is, the point at which the closed pressure approaches as nearly as possible the maximum pressure which would be shown if all wells in the pool were closed for several months. The length of time required varies with the character of the sand, position of the packer, the location of the well with reference to other wells, the limits of the pool, and other factors. The depth of the well, diameter of tubing, and line pressure when the well was shut off, should be noted. Since readings at the exact end of the taxable year will ordinarily not be available, the pressure of that date may be obtained by interpolation or extrapolation. In certain cases readings taken regularly in September or some other month may be applicable to the end of the taxable year. As a general rule September closed pressure readings furnish the best indication of depletion and it is recommended that such readings be made with regularity and care. Where interpolated or extrapolated readings are used the data from which they are obtained should be given. Gauges should be of appropriate capacity and should be frequently tested. A record should be kept of the number of gauges, date each was tested, names of men testing, and other significant details.

ART. 213. **Computation of allowance where quantity of oil or gas uncertain.**—If by reason of the youth of the field, the restricted production, or for any other cause, it is not possible to determine with any degree of certainty the quantity of oil or gas in a property, it will be necessary to make a tentative estimate, which will apply until production figures are available from which an accurate determination may be made.

ART. 214. **Computation of depletion allowance for combined holdings of oil and gas wells.**—(1) The recoverable oil belonging to the taxpayer shall be estimated for each property separately. The capital account for each property shall include the cost or value, as the case may be, of the oil or gas lease or rights plus all incidental costs of development not charged as expense nor returnable through depreciation. The unit value of the recoverable oil or gas for each property is the quotient obtained by dividing the capital account recoverable through depletion for each property by the estimated number of units of recoverable oil or gas on that property. This unit for each separate property multiplied by the number of units of oil or gas produced within the year by the taxpayer upon such property will determine the amount which may be deducted for depletion from the gross income of that year for that property. The total allowance for depletion of all the oil or gas properties of the taxpayer will be the sum of the amounts computed for each property separately: *Provided* (2), That in the case of gas properties the depletion allowance for each pool may be computed by using the combined capital account returnable through depletion of all the tracts of gas land owned by the taxpayer in the pool and the average decline in rock pressures of all the taxpayer's wells in such pool in the formula given in article 211. The total allowance for depletion in the gas properties of the taxpayer will be the sum of the amounts computed for each pool.

ART. 215. **Depletion—Adjustments of accounts based on bonus or advanced royalty.**—(*a*) Where a lessor receives a bonus or other sum in addition to royalties, such bonus or other sum shall be regarded as a return of capital to the lessor, but only to the extent of the capital remaining to be recovered through depletion by the lessor at the date of lease. If the bonus exceeds the capital remaining to be recovered, the excess and all the royalties thereafter received will be income and not depletable. If the bonus is less than the capital remaining to be recovered by the lessor through depletion, the difference may be recovered through depletion deductions based on the royalties thereafter received. The bonus or other sum paid by the lessee for a lease made on or after March 1, 1913, will be his value for depletion as of date of acquisition.

(*b*) Where the owner has leased a mineral property for a term of years with a requirement in the lease that the lessee shall extract and pay for, annually, a specified number of tons, or other agreed units of measurement, of such mineral, or shall pay, annually, a specified sum of money which shall be applied in payment of the purchase price or royalty per unit of such mineral whenever the same shall thereafter be extracted and removed from the leased premises, the value in the ground to the lessor, for purposes of depletion, of the number of units so paid for in advance of extraction will constitute an allowable deduction from the gross income of the year in which such payment or payments shall be made; but no deduction for depletion by the lessor shall be claimed or allowed in any subsequent year on account of the extraction or removal in such year of any mineral so paid for in advance and for which deduction has once been made.

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

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

ART. 216. **Depletion and depreciation accounts on books.**—Every taxpayer claiming and making a deduction for depletion and depreciation of mineral property shall keep accurate ledger accounts in which shall be charged the fair market value as of March 1, 1913, or within 30 days after the date of discovery, or the cost, as the case may be, (*a*) of the mineral deposit, and (*b*) of the plant and equipment, together with subsequent allowable capital additions to each account. These accounts shall thereafter be credited annually with the amounts, whether legally allowable or not, of the depletion and depreciation sustained; or the amounts of the depletion and depreciation sustained shall be credited to depletion and depreciation reserve accounts, to the end that when the sum of the credits for depletion and depreciation equals the value or cost of the property, plus subsequent allowable capital additions, no further deduction for depletion and depreciation with respect to the property shall be allowed.

ART. 217. **Statement to be attached to return when depletion or depreciation of mineral property is claimed.**—(*a*) To the return of every taxpayer claiming a deduction for depletion or depreciation there shall be attached a statement setting forth with respect to each mineral property; (1) whether taxpayer is a fee owner, lessor, or lessee, (2) the date of acquisition and if under lease, its exact terms and date of expiration, (3) the cost of the property stating the amount paid to each vendor with his name and address, (4) the basic date at which the property is valued, (5) the value of the property on the basic date with a statement of the precise method by which it was determined, (6) the value of the surface of the land for purposes other than mineral production, (7) the estimated number of units of mineral at the basic date with an explanation of the method used in the estimation, and an average analysis which will indicate the quality of the mineral valued, (8) the number of units sold during the year for which the return is made, (9) the gross and net income derived from the sale of mineral, (10) the amounts deducted for depletion, (11) the amounts sustained on account of depletion or on account of depreciation stated separately from the basic date to the taxable year, and (12) any other data which will be helpful in determining the reasonableness of the deductions claimed in the return.

(*b*) To the return of every taxpayer claiming a deduction for depletion in respect of (1) property in which he owns a fractional interest only, or (2) a leasehold, or (3) property subject to lease, there shall also be attached a statement setting forth the name and address and the precise nature of the holding of each person interested in the property, and every lessor shall attach to his return an affidavit stating, as of the date of filing the return, whether the lease involved is still in effect during the year covered by the return, and, if not still in effect, when it was terminated and for what reason and whether the lessor has repossessed the property.

ART. 218. **Statement to be attached to return where depletion of oil or gas claimed.**—To each return made by a person owning or operating oil or gas properties, there should be attached a statement showing for each property the following information, which may be given in the form of a table, if desired, by taxpayers owning more than one property: (*a*) the fair market value of the property (exclusive of machinery, equipment, etc., and the value of the surface rights) as of March 1, 1913, if acquired prior to that date; or the fair market value of the property within 30 days after the date of discovery; or the actual cost of the property, if acquired subsequently to February 28, 1913, and not covered by the foregoing clause; (*b*) how the fair market value was ascertained, if the property came under the first or second head under (*a*); (*c*) the estimated quantity of oil or gas in the property at the time that the value or cost was determined; (*d*) the name and address of the person making the estimate and the manner in which this estimate was made, including a summary of the calculations; (*e*) the amount of capital applicable to each unit (this being found by dividing the value or cost, as the case may be, by the estimated number of units of oil or gas in the property at the time the value or cost was determined); (*f*) the quantity of oil or gas produced during the year for which the return is made (in the case of new properties it is desirable that this information be furnished by months); (*g*) the number of acres of producing and proven oil or gas land; (*h*) the number of wells producing at the beginning and end of the taxable year; (*i*) the date of completion of wells finished during the taxable year; (*j*) the date of abandonment of all wells abandoned during the taxable year; (*k*) a property map showing the location of the property and of the producing and abandoned wells, dry holes, and proven oil and gas lands; (*l*) the average gravity of the oil produced on the tract; (*m*) the number of pay sands and average thickness of each pay sand or zone on the property; (*n*) the average depth to the top of each of the different pay sands; (*o*) any data regarding change in operating conditions, such as flooding, use of compressed air, vacuum, shooting, etc., which have a direct effect on the production of the property; (*p*) the monthly or annual production of individual wells and the initial daily production of new wells (this is highly desirable information and should be furnished wherever possible); (*q*) (for the first year in which the above information is filed for a property which was producing prior to the taxable year covered by the above statement the following information must be furnished) annual production of the tract or of the individual wells, if the latter information is available, from the beginning of its productivity to the beginning of the taxable year for which the return was filed; the average number of wells producing during each year; and the initial daily production of each well; and (*r*) any other data which will be helpful in determining the reasonableness of the depletion deduction. When a taxpayer has filed adequate maps with the Commissioner he may be relieved of filing further maps of the same properties, provided all additional information necessary for keeping the maps up to date is filed each year. This includes records of dry holes, as well as producing wells, together with logs, depth and thickness of sands, location of new wells, etc. By "production" is meant the net production of oil or gas belonging to the taxpayer. In those leases where no account is kept of the oil or gas used for fuel, the production will necessarily be that remaining after the fuel used in the property has been taken out. In cases of this kind an estimate of the fuel used from each tract should be given for each year.

ART. 219. **Discovery of mines.**—(*a*) To entitle a taxpayer to a valuation of his property, for the purpose of depletion allowances, by reason of the discovery of a mine on or after March 1, 1913, the discovery must be made by the taxpayer after that date, and must result in the fair market value of the property becoming disproportionate to the cost. The fair market value of the property will be deemed to have become disproportionate to the cost when the newly discovered mine contains mineral in such quantity and of such quality as to afford a reasonable expectation of return to the taxpayer of an amount materially in excess of the capital expended in making such discovery plus the cost of future development, equipment, and exploitation.

(*b*) For the purpose of these sections of the Act a mine may be said to be discovered when (1) there is found a natural deposit of mineral, or (2) there is disclosed by drilling or exploration, conducted above or below ground, a mineral deposit not previously known to exist and so improbable that it had not been, and could not have been, included in any previous valuation for the purpose of depletion, and which in either case exists in quantity and grade sufficient to justify commercial exploitation. The discovery must add a new mine to those previously known to exist and can not be made within a proven tract or lease as defined in paragraph (*f*) infra.

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

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

(*e*) After a *bona fide* discovery the taxpayer shall adjust his capital and depletion accounts in accordance with articles 206, 208, and 210, and shall submit such evidence as to establish his right to a revaluation, covering the conditions and circumstances of the discovery and the size, character, and location of the discovered deposit of mineral, the value of the property at the prior basic date, the cost of discovery, and its development, equipment, and exploitation, its value and the particular method used in the determination.

(*f*) In the case of a mine, a " proven tract or lease " includes, but is not necessarily limited to, the mineral deposits known to exist in any known mine at the date as of which such mine was valued for purposes of depletion, and all extensions thereof, including " probable " and " prospective " ores considered as a factor in the determination of the value or cost.

ART. 220. **Oil and gas wells.**—Section 214(a) (10) and section 234(a) (9) provide that taxpayers who discover oil and gas wells on or after March 1, 1913, may, under the circumstances therein prescribed, determine the fair market value of such property at the date of discovery or within 30 days thereafter for the purpose of ascertaining allowable deductions for depletion. Before such valuation may be made the statute requires that two conditions precedent be satisfied, (1) that the fair market value of such property (oil and gas wells) on the date of discovery or within 30 days thereafter became materially disproportionate to the cost, by virtue of the discovery, and (2) that such oil and gas wells were not acquired as the result of purchase of a proven tract or lease.

ART. 220(a). **Discovery—Proven tract or lease—Property disproportionate value.**—(1) For the purpose of these sections of the Revenue Act of 1918, an oil or gas well may be said to be discovered when there is either a natural exposure of oil or gas, or a drilling that discloses the actual and physical presence of oil or gas in quantities sufficient to justify commercial exploitation. Quantities sufficient to justify commercial exploitation are deemed to exist when the quantity and quality of the oil or gas so recovered from the well are such as to afford a reasonable expectation of at least returning the capital invested in such well through the sale of the oil or gas, or both to be derived therefrom.

(2) A proven tract or lease may be a part or the whole of a proven area. A proven area for the purposes of this statute shall be presumed to be that portion of the productive sand or zone or reservoir included in a square surface area of 160 acres having as its center the mouth of a well producing oil or gas in commercial quantities.

In other words, a producing well shall be presumed to prove that portion of a given sand, zone, or reservoir which is included in an area of 160 acres of land, *regardless of private boundaries.* The center of such square area shall be the mouth of the well, and its sides shall be parallel to the section lines established by the United States system of public land surveys in the district in which it is located. Where a district is not covered by the United States land surveys the sides of said area shall run north and south, east and west.

So much of a taxpayer's tract or lease which lies within an area proven either by himself or by another is "a proven tract or lease" as contemplated by the statute, and the discovery of a well thereon will not entitle such taxpayer to revalue such well for the purpose of depletion allowances, unless the tract or lease had been acquired before it became proven. And even though a well is brought in on a tract or lease not included in a proven area as heretofore defined, nevertheless it may not entitle the owner of the tract or lease in which such well is located to revaluation for depletion purposes, if such tract or lease lies within a compact area which is immediately surrounded by proven land, and the geologic structural conditions on or under the land so inclosed may reasonably warrant the belief that the oil or gas of the proven areas extends thereunder. Under such circumstances the entire area is to be regarded as proven land.

(3) The "property" which may be valued after discovery is the "well." For the purposes of these sections the "well" is the drill hole, the surface necessary for the drilling and operation of the well, the oil or gas content of the particular sand, zone, or reservoir (limestone, breccia, crevice, etc.) in which the discovery was made by the drilling, and from which the production is drawn, to the limit of the taxpayer's private bounding lines, but not beyond the limits of the proven area as heretofore provided.

(4) A taxpayer to be entitled to revalue his property after March 1, 1913, for the purpose of depletion allowances must make a discovery after said date, and such discovery must result in the fair market value of the property becoming disproportionate to the cost. The fair market value of the property will be deemed to have become disproportionate to the cost when the output of such well of oil or gas affords a reasonable expectation of returning to the taxpayer an amount materially in excess of the cost of the land or lease if acquired since March 1, 1913, or its fair market value on March 1, 1913, if acquired prior thereto, plus the cost of exploration and development work to the time the well was brought in.

ART. 221. **Proof of discovery of oil and gas wells.**—In order to meet the requirements of the preceding article to the satisfaction of the Commissioner, the taxpayer will be required, among other things, to submit the following with his return: (*a*) a map of convenient scale, showing the location of the tract and discovery well in question and of the nearest producing well, and the development for a radius of at least 3 miles from the tract in question, both on the date of discovery and on the date when the fair market value was set; (*b*) a certified copy of the log of the discovery well showing the location, the date of drilling began, the date of completion and beginning of production, the formations penetrated, the oil, gas, and water sands penetrated, the casing record, including the record of perforations, and any other information tending to show the condition of the well and the location of the sand or zone from which the oil or gas is produced on the date the discovery was claimed; (*c*) a sworn record of production, clearly proving the commercial productivity of the discovery well; (*d*) a sworn copy of the records, showing the cost of the property; and (*e*) a full explanation of the method of determining the value on the date of discovery or within 30 days thereafter, supported by satisfactory evidence of the fairness of this value.

ART. 222. **Allowable capital additions in case of mines.**—(*a*) All expenditures for development, rent, and royalty in excess of receipts from minerals sold, shall be charged to capital account recoverable through depletion, while the mine is in the development stage. Thereafter any development which adds value to the mineral deposit beyond the current year shall be carried as a deferred charge and apportioned and deducted as operating expense in the years to which it is applicable.

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

ART. 223. **Charges to capital and to expense in the case of oil and gas wells.**—Such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling of wells, building of pipe lines, and development of the property may at the option of the taxpayer be deducted as an operating expense or charged to the capital account returnable through depletion. If in exercising this option the taxpayer charges these incidental expenses to capital account, in so far as such expense is represented by physical property it may be taken into account in determining a reasonable allowance for depreciation. The cost of drilling nonproductive wells may at the option of the operator be deducted from gross income as an operating expense or charged to capital account returnable through depletion and depreciation as in the case of productive wells. An election once made under this option will control the taxpayer's returns for all subsequent years. Casing-head gas contracts have been construed to be tangible assets and their cost may be added to the capital account returnable through depletion, following the rate set by the oil wells from which the gas is derived, or, if the life of the contract is shorter than the reasonable expectation of the life of the wells furnishing the gas, the capital invested in the contract may be written off through yearly allowances equitably distributed over the life of the contract. All oil produced during the taxable year, whether sold or unsold, must be considered in the computation of the depletion allowance for that year. In computing net income all oil in storage at the beginning and at the end of the taxable year must be inventoried at cost, that is, unit cost plus lifting cost. Where deductions for depreciation or depletion have either on the books of the taxpayer or in his returns of net income been included in the past in expense or other accounts, rather than specifically as depreciation or depletion, or where capital expenditures have been charged to expense in lieu of depreciation or depletion, a statement indicating the extent to which this practice has been carried should accompany the return.

ART. 224. **Depreciation in the case of mines.**—(*a*) The Act provides that deductions for depreciation of improvements "according to the peculiar conditions in each case" may be taken by a taxpayer owning or leasing mining property. This is deemed to include exhaustion and wear and tear of the property used in mining of deposits, comprising a reasonable allowance for obsolescence. (See articles 161–171.)

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

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

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

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

(*f*) Nothing in these regulations shall be interpreted as meaning that the value of a mining plant and equipment may be reduced by depreciation deductions to a sum below the value of the salvage when the property shall have become obsolete or shall have been abandoned for the purpose of mining. In estimating the salvage value of the equipment at the end of its estimated economic life due consideration may be given to its specialized character and the cost of dismounting and dismantling and transporting it to market.

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

ART. 225 **Depreciation of improvements in the case of oil and gas wells.**—Both owners and lessees operating oil or gas properties will, in addition to and apart from the deduction allowable for the depletion or return of capital as hereinbefore provided, be permitted to deduct a reasonable allowance for depreciation of physical property, such as machinery, tools, equipment, pipes, etc., so far as not in conflict with the option exercised by the taxpayer under article 223. The amount deductible on this account shall be such an amount based upon its cost or fair market value as of March 1, 1913, equitably distributed over its useful life as will bring such property to its true salvage value when no longer useful for the purpose for which such property was acquired. Accordingly, where it can be shown to the satisfaction of the Commissioner that the reasonable expectation of the economic life of the oil or gas deposit with which the property is connected is shorter than the normal useful life of the physical property, the amount annually deductible for depreciation may for such property be based upon the length of life of the deposit. See articles 161–170.

ART. 226. **Depletion and depreciation of oil and gas wells in years before 1916.**—If upon examination it is found that in respect of the entire drilling cost of wells, including physical property and incidental expenses, between March 1, 1913, and December 31, 1915, a taxpayer has been allowed a reasonable deduction sufficient to provide for the elements of exhaustion, wear and tear, and depletion, it will not be necessary to reopen the returns for years prior to 1916 in order to show separately in these years the portions of such deduction representing depletion and depreciation, respectively. Such separation will be required to be made of the reserves for depreciation at January 1, 1916, and proper allocation between depreciation and depletion must be maintained after that date. In any case in which it is found that the deductions taken between March 1, 1913, and December 31, 1915, are not reasonable, amended returns may be required for these years. See article 839.

ART. 227. **Depletion of timber.**—A reasonable deduction from gross income for the depletion of timber and for the depreciation of improvements is permitted, based (*a*) upon cost if acquired after February 28, 1913, or (*b*) upon the fair market value as of March 1, 1913, if acquired prior thereto. The essence of this provision is that the owner of timber property, whether it be a leasehold or a freehold, shall secure through an aggregate of annual depletion and depreciation deductions a return of the amount of capital invested by him in the property, or in lieu thereof an amount equal to its fair market value as of March 1, 1913, plus in any case the subsequent cost of plant, equipment, and development which is not chargeable to current operating expenses, but not including cut-over land values.

ART. 228. **Capital recoverable through depletion allowance in the case of timber.**—In general, the capital remaining in any year recoverable through depletion allowances may be determined as indicated in articles 202, 203, and 204. In the case of leases the apportionment of deductions between the lessor and lessee will be made as specified in articles 203 and 204. The cost of timber properties shall be determined in accordance with the principles indicated in article 205. For method of determining fair market value and quantity of timber, see articles 234, 235, and 236. For depletion purposes the cost of the timber shall not include any part of the cost of the land.

ART. 229. **Computation of allowance for depletion of timber for given year.**—The allowance for depletion of timber in any taxable year shall be based upon the number of units of timber felled during the year and the unit value of the timber in the timber account or accounts pertaining to the timber cut. The unit value of the timber for a given timber account in a given year shall be the quotient obtained by dividing (*a*) the total number of units of timber on hand in the given account at the beginning of the year plus the number of units acquired during the year plus (or minus) the number of units required to be added (or deducted) by way of correcting the estimate of the number of units remaining available in the account into (*b*) the total fair market value as of March 1, 1913, and (or) cost of the timber on hand at the beginning of the year, plus the cost of the number of units acquired during the year, plus proper additions to capital (see art. 231). The amount of the deduction for depletion in any taxable year with respect to a given timber account shall be the product of (*a*) the number of units of timber cut from the given account during the year multiplied by (*b*) the unit value of the timber for the given account for the year. Those taxpayers who keep their accounts on a monthly basis may, at their option, keep their depletion accounts on a monthly basis, in which case the amount deductible on account of depletion for a given month will be determined in the manner outlined above for a given year. The total amount of the deduction for depletion in any taxable year shall be the sum of the amounts deductible for the several timber accounts. For description of timber accounts, see articles 235 and 236.

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

ART. 230. **Revaluation of timber not allowed.**—In the case of timber acquired prior to March 1, 1913, the fair market value as of that date shall, when determined and approved by the Commissioner, be the basis for determining the depletion deduction for each year during the continuance of the ownership under which the fair market value of the timber was fixed, and during such ownership there shall be no redetermination of the fair market value of the timber for such purpose. However, the unit market (or cost) value of the timber will subsequently be changed if from any cause such unit market (or cost) value, if continued as a basis of depletion, shall upon evidence satisfactory to the Commissioner be found inadequate or excessive for the extinguishment of the cost, or fair market value as of March 1, 1913, of the timber.

ART. 231. **Charges to capital and to expenses in the case of timber.**—In the case of a timber property held for future operation by an owner having no substantial income from the property or from other sources, all expenditures for administration, protection, and other carrying charges prior to production on a normal basis shall be charged to capital account; after such a property is on a normal production basis such expenditures shall be treated as current operating expenses. In case a taxpayer, who has a substantial income from other sources, owns a timber property which is not yet on a normal production basis, he may, at his option, charge such expenditures with respect to such timber property to capital, or treat them as current operating expenses, but whichever system is adopted must be followed until permission to change to the other system is secured from the Commissioner. In the case of timber operations all expenditures prior to production for plants, improvements, and equipment, and thereafter all major items of plant and equipment, shall be charged to capital account for purposes of depreciation. After a timber operation has been developed and equipped and has reached its normal output capacity, the cost of additional minor items of equipment and the cost of replacement of minor items of worn-out and discarded plant and equipment may be charged to current operating expenses, unless the taxpayer elects to write off such expenditures through charges for depreciation; however, the method adopted must be followed consistently from year to year.

ART. 232. **Depreciation of improvements in the case of timber.**—The cost or value as of March 1, 1913, as the case may be, of development not represented by physical property having an inventory value, and such cost or value of all physical property which has not been deducted and allowed as expense in the returns of the taxpayer, shall be recoverable through depreciation. It shall be optional with the taxpayer, subject to the approval of the Commissioner, (*a*) whether the cost or value, as the case may be, of the property subject to depreciation shall be recovered at a rate established by current exhaustion of stumpage, or (*b*) whether the cost or value shall be recovered by appropriate charges for depreciation calculated by the usual rules for depreciation or according to the peculiar conditions of the taxpayer's case by a method satisfactory to the Commissioner. In no case may charges for depreciation be based on a rate which will extinguish the cost or value of the property prior to the termination of its useful life. Nothing in these regulations shall be interpreted to mean that the value of a timber plant and equipment, so far as it is represented by physical property having an inventory value, may be reduced by depreciation deductions to a sum below the value of the salvage when the plant and equipment shall have become obsolete or worn out or shall have been abandoned, or that any part of the value of cut-over land may be recoverable through depreciation.

ART. 233. **Information to be furnished by taxpayer claiming depletion of timber.**—To the income tax return of the taxpayer claiming a deduction for depletion or depreciation or both there shall be attached a map and statement (Form T–Timber) for the taxable year covered by the income tax return. Form T–Timber requires the following: (*a*) Map showing timber and land acquired, timber cut, and timber and land sold; (*b*) description of, cost of, and terms of purchase or lease of, timber and land acquired; (*c*) proof of profit or loss from sale of capital assets; (*d*) description of timber with respect to which claim for loss, if any, is made; (*e*) record of timber cut; (*f*) changes in each timber account as the result of purchase, sale, cutting, re-estimate, or loss; (*g*) changes in physical property accounts as the result of additions to or deductions from capital and depreciation; (*h*) operation data with respect to raw and finished materials handled and inventoried; (*i*) unit production costs; and (*j*) any other data which will be helpful in determining the reasonableness of the depletion and (or) depreciation deductions claimed in the return. Similar information is required for certain years prior to the 1919 taxable year from those taxpayers who have not already furnished it. The specific nature of the information required for the earlier years is given in detail in Form T–General forest industries questionnaire for the years prior to 1919.

ART. 234. **Determination of fair market value of timber.**—Where the fair market value of the property at a specified date, in lieu of the cost thereof, is the basis for depletion and depreciation deductions, such value shall be determined, subject to approval or revision by the Commissioner upon audit, by the owner of the property in the light of the most reliable and accurate information available with reference to the condition of the property as it existed at that date, regardless of all subsequent changes, such as changes in surrounding circumstances, in methods of exploitation, in degree of utilization, etc. The value sought will be the selling price, assuming a transfer between a willing seller and a willing buyer as of the particular date. Such factors as the following will be given due consideration: (*a*) Character and quality of the timber as determined by species, age, size, condition, etc.; (*b*) the quantity of timber per acre, the total quantity under consideration, and the location of the timber in question with reference to other timber; (*c*) accessibility of the timber (location with reference to distance from a common carrier, the topography and other features of the ground upon which the timber stands and over which it must be transported in process of exploitation, the probable cost of exploitation, and the climate and the state of industrial development of the locality); and (*d*) the freight rates by common carrier to important markets. The timber in question will be valued on its own merits and not on the basis of general averages for regions; however, the value placed upon it, taking into consideration such factors as those mentioned above, will be consistent with that of the other timber in the region. The Commissioner will give due weight and consideration to any and all facts and evidences having a bearing on the market value, such as cost, actual sales and transfers of similar properties, the margin between the cost of production and the price realized for timber products, market value of stock or shares, royalties and rentals, value fixed by the owner for the purpose of the capital stock tax, valuation for local or State taxation, partnership accountings, records of litigation in which the value of the property has been involved, the amount at which the property may have been inventoried and (or) appraised in probate or similar proceedings, disinterested appraisals by approved methods, and other factors. For depletion purposes the fair market value at a specified date shall not include any part of the value of the land.

ART. 235. **Determination of quantity of timber.**—Each taxpayer claiming or expecting to claim a deduction for depletion is required to estimate with respect to each separate timber account the total units (feet board-measure log scale, cords, or other units) of timber reasonably known or on good evidence believed to have existed on the ground on March 1, 1913, or on the date of acquisition of the property, as the case may be. This estimate shall state as nearly as possible the number of units which would have been found present by a careful estimate made on the specified date with the object of determining 100 per cent of the quantity of timber which the area would have produced on that date if all of the merchantable timber had been cut and utilized in accordance with the standards of utilization prevailing in that region at that time. If subsequently during the ownership of the taxpayer making the return, as the net result of the growth of the timber, of changes in standards of utilization, of losses not otherwise accounted for, of abandonment of timber, and (or) of errors in the original estimates, there are found to remain on the ground, available for utilization, more or less units of timber than remain in the timber account or accounts, a new estimate of the recoverable units of timber (but not of the cost or the fair market value at a specified date) shall be made, and, when made, shall thereafter constitute a basis for depletion.

ART. 236. **Aggregating timber and land for purposes of valuation and accounting.**—With a view to logical and reasonable valuation of timber, the taxpayer shall include his timber in one or more accounts. In general, each such account shall include all of the taxpayer's timber which is located in one "block," a block being an operation unit which includes all of the taxpayer's timber which would logically go to a single given point of manufacture. In those cases in which the point of manufacture is at a considerable distance, or in which the logs or other products will probably be sold in a log or other market, the block may be a logging unit which includes all of the taxpayer's timber which would logically be removed by a single logging development. In exceptional cases, provided there are good and substantial reasons, and subject to approval or revision by the Commissioner on audit, the taxpayer may divide the timber in a given block into two or more accounts, e. g., timber owned on February 28, 1913, and that purchased subsequently may be kept in separate accounts, or timber owned on February 28, 1913, and the timber purchased since that date in several distinct transactions may be kept in several distinct accounts, or individual tree species or groups of tree species may be carried in distinct accounts, or special timber products may be carried in distinct accounts, or blocks may be divided into two or more accounts based on the character of the timber and (or) its accessibility, or scattered tracts may be included in separate accounts. When such a division is made, a proper portion of the total value or cost, as the case may be, shall be allocated to each account.

The timber accounts mentioned in the preceding paragraph shall not include any part of the value or cost, as the case may be, of the land. In a manner similar to that prescribed in the foregoing part of this article the land in a given "block" may be carried in a single land account or may be divided into two or more accounts on the basis of its character and (or) accessibility. When such a division is made, a proper portion of the total value or cost, as the case may be, will be allocated to each account.

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

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

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

Art. 237. **Timber depletion and depreciation accounts on books.**—Every taxpayer claiming or expecting to claim a deduction for depletion and (or) depreciation of timber property (including plants, improvements and equipment used in connection therewith) shall keep accurate ledger accounts in which shall be charged the fair market value as of March 1, 1913, or the cost, as the case may be, of (*a*) the property, and (*b*) the plants, improvements and equipment, together with such amounts subsequently expended for the administration, protection, and other carrying charges, or development of the property or additions to plant and equipment as are not chargeable to current operating expenses. (See arts. 231 and 236.) In such accounts there shall be set up separately the quantity of timber, the quantity of land, and the quantity of other resources, if any, and a proper part of the total value or cost shall be allocated to each. (See art. 236.) These accounts shall be credited with the amount of the depreciation and depletion deductions claimed and allowed each year, or the amount of the depreciation and depletion shall be credited to depletion and depreciation reserve accounts, to the end that when the sum of the credits for depletion and depreciation equals the value or cost of the property, plus the amount added thereto for administration, protection, and other carrying charges, or development or for additional plant and equipment, less salvage value of the physical property, no further deduction for depletion and depreciation will be allowed.

DEDUCTIONS ALLOWED: CHARITABLE CONTRIBUTIONS.

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

(11) Contributions or gifts made within the taxable year to corporations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, or to the special fund for vocational rehabilitation authorized by section 7 of the Vocational Rehabilitation Act, to an amount not in excess of 15 per centum of the taxpayer's net income as computed without the benefit of this paragraph. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary. In the case of a nonresident alien individual this deduction shall be allowed only as to contributions or gifts made to domestic corporations, or to such vocational rehabilitation fund; * * *

ART. 251. **Charitable contributions.**—Contributions or gifts within the taxable year are deductible to an aggregate amount not in excess of 15 per cent of the taxpayer's net income, including such payments, if made (*a*) to corporations or associations of the kind exempted from tax by subdivision (6) of section 231 of the statute or (*b*) to the special fund for vocational rehabilitation under the Vocational Rehabilitation Act of June 27, 1918. For a discussion of what corporations and associations are included within (*a*) see article 517. A gift to a common agency (as a war chest) for several such corporations or associations is treated like a gift direct to them. In connection with claims for this deduction there shall be stated on returns of income the name and address of each organization to which a gift was made and the approximate date and the amount of the gift in each case. Where the gift is other than money the basis for calculation of the amount of the gift shall be the cost of the property, if acquired after February 28, 1913, or its fair market value as of March 1, 1913, if acquired prior thereto, after deducting from such cost or value the amount, if any, which has been or which should have been set aside and deducted in the current year and previous years from gross income on account of depreciation, and which has not been paid out in making good the depreciation sustained. A gift of real estate to a city to be maintained perpetually as a public park is not an allowable deduction. The proportionate share of contributions made by a partnership to corporations or associations of the kind included in (*a*) above and to the special fund for vocational rehabilitation specified in (*b*) may be claimed as deductions in the personal returns of the partners to an amount which, added to the amount of such contributions made by the partner individually, is not in excess of 15 per cent of the partner's net income computed without the benefit of the deduction for such contributions. However, the contributions made by the partnership shall not be deducted from its gross income in ascertaining the amount of its net income to be reported on form 1065 (revised). See article 321. This article does not apply to gifts by estates and trusts or corporations. See section 219 of the statute and articles 561 and 562.

DEDUCTIONS ALLOWED: LOSS IN INVENTORY.

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

(12) (a) At the time of filing return for the taxable year 1918 a taxpayer may file a claim in abatement based on the fact that he has sustained a substantial loss (whether or not actually realized by sale or other disposition) resulting from any material reduction (not due to temporary fluctuation) of the value of the inventory for such taxable year, or from the actual payment after the close of such taxable year of rebates in pursuance of contracts entered into during such year upon sales made during such year. In such case payment of the amount of the tax covered by such claim shall not be required until the claim is decided, but the taxpayer shall accompany his claim with a bond in double the amount of the tax covered by the claim, with sureties satisfactory to the Commissioner, conditioned for the payment of any part of such tax found to be due, with interest. If any part of such claim is disallowed then the remainder of the tax due shall on notice and demand by the collector be paid by the taxpayer with interest at the rate of 1 per centum per month from the time the tax would have been due had no such claim been filed. If it is shown to the satisfaction of the Commissioner that such substantial loss has been sustained, then in computing the tax imposed by this title the amount of such loss shall be deducted from the net income. (b) If no such claim is filed, but it is shown to the satisfaction of the Commissioner that during the taxable year 1919 the taxpayer has sustained a substantial loss of the character above described then the amount of such loss shall be deducted from the net income for the taxable year 1918 and the tax imposed by this title for such year shall be redetermined accordingly. Any amount found to be due to the taxpayer upon the basis of such redetermination shall be credited or refunded to the taxpayer in accordance with the provisions of section 252. * * *

ART. 261. **Losses in inventory and from rebates.**—Taxpayers are allowed deductions from net income for the taxable year 1918 for losses resulting (*a*) from material reductions after the close of the taxable year 1918 of the values of inventories for such taxable year, and (*b*) from actual payments after the close of the taxable year 1918 of rebates in pursuance of contracts entered into during such year upon sales made during such year. The taxable year of the taxpayer, whether calendar or fiscal, is meant in every case. Such deductions may be secured by two methods, either by a claim in abatement or by a claim for refund, and must not be entered upon the regular return.

ART. 262. **Loss from rebates.**—Where after the close of the taxable year 1918 rebates have been bona fide paid in pursuance of contracts entered into during such year upon sales made during such year, the net income for that year may be reduced by the deduction of the amount of such rebates actually paid. No such deduction will be allowed unless the profits from such sales have been included in the income for the taxable year 1918.

ART. 263. **Loss in inventory.**—Inventory losses are allowable either (*a*) where goods included in an inventory at the end of the taxable year 1918 have been sold at a loss during the succeeding taxable year, or (*b*) where such goods remain unsold throughout the taxable year 1919 and at its close have a then market value (not resulting from a temporary fluctuation) materially below the value at which they were inventoried at the end of the taxable year 1918. No deduction is allowable for losses of anticipated profits or for losses not substantial in amount, nor for physical damage or obsolescence occurring in the taxable year 1919. In determining whether goods included in an inventory at the end of the taxable year 1918 have been sold during the succeeding taxable year, and whether loss has resulted therefrom, sales of goods made in the taxable year 1919 will be deemed to have been made from the inventoried stock of 1918 until such inventoried stock is exhausted.

ART. 264. **Loss where goods have been sold.**—Where goods included in the inventory at the end of the taxable year 1918 have been sold during the succeeding taxable year, the loss which may be deducted from net income for the taxable year 1918 is the amount by which the value at which the goods sold were included in the inventory exceeds the actual selling price minus a reasonable allowance for selling expenses and for manufacturing expenses, if any, incurred in the taxable year 1919 and attributable to such goods.

ART. 265. **Loss where goods have not been sold.**—Where goods included in the inventory at the end of the taxable year 1918 have not been sold during the succeeding taxable year, the loss which may be deducted from net income for the taxable year 1918 is the amount by which the net income for such year would be reduced if the inventory were redetermined and such goods taken at their market value (ignoring mere temporary fluctuations of value) at the end of the taxable year 1919.

ART. 266. **Claims.**—Claims in abatement should be filed with the collector on form 47 when the return for the taxable year 1918 is made. Claims for refund should be filed on form 46 not later than 30 days after the close of the taxable year 1919. Each claim shall contain a concise statement of the amount of the loss sustained and the basis upon which it has been computed, together with all pertinent facts necessary to enable the Commissioner to determine the allowability of the claim. The amount allowed by the Commissioner in respect of any such claim shall be deducted from the net income for the taxable year 1918 and the taxes shall be recomputed accordingly. Any excess paid over the tax due shall be credited or refunded to the taxpayer. See section 252 of the statute and articles 1031–1038. In computing income for the taxable year 1919 the opening inventory must be properly adjusted by the taxpayer in respect of any claim allowed for the year 1918 under this article.

ART. 267. **Disposition of claims.**—A claim for loss resulting from rebates paid or from actual sales will be decided as soon as practicable after it has been filed. A claim for loss in inventory not realized by sale will be decided only after the close of the taxable year 1919 upon the basis of any permanent reduction in the level of market values which may occur during such year from the inventory values taken at the close of the taxable year 1918. Not later than thirty days after the close of the taxable year 1919 a taxpayer who has filed either a claim in abatement or a claim for refund, or both, shall submit to the Commissioner a descriptive statement showing the quantity and kind of all goods included in the 1918 inventory which have been (*a*) sold at a loss in the taxable year 1919, (*b*) sold at a profit during the taxable year 1919, or (*c*) not sold or otherwise disposed of during the taxable year 1919, together with such other information in respect of such goods as the Commissioner may require. A claim filed with the return for a loss not then realized by sale will be passed upon in the light of any sales thereafter made during the taxable year 1919. A claim filed with the return is authorized for the purpose of allowing the taxpayer to utilize, where justified, a preliminary allowance for inventory losses and not to provide a deduction essentially different from that taken by way of a claim filed at the end of the taxable year 1919.

ART. 268. **Effect of claim in abatement.**—In the case of a claim in abatement filed with a return payment of the amount of the tax covered thereby shall not be required until the claim is decided, provided the taxpayer files therewith a bond on form 1124 in double the amount of the tax covered by the claim, conditioned for the payment of any part of such tax found to be due with interest at the rate of 12 per cent per annum. The bond shall be executed by a surety company holding a certificate of authority from the Secretary of the Treasury as an acceptable surety on federal bonds and shall be subject to the approval of the Commissioner. See also section 1320 of the statute. If abatement of any part of the tax covered by such a claim is denied, then such part shall be paid by the taxpayer with interest at the rate of 12 per cent per annum from the original due date of the tax.

The bond executed on form 1124, pursuant to this article, together with the abatement claim, should be forwarded by the collector to the Commissioner of Internal Revenue. When it is received by the Commissioner it will be detached from the abatement claim and forwarded to the surety bond section of the Treasury Department for certification as to the sufficiency of the sureties. The surety bond section will, after certification, return the bond to the Commissioner for his approval. When he has approved the bond he will cause it to be attached to the abatement claim.

In case the claimant, in accordance with the provisions contained in section 1320 of the Revenue Act of 1918, elects to offer, in lieu of the surety or sureties provided for on form 1124, United States Liberty bonds or other bonds of the United States as security he should execute in duplicate a bond and agreement on form 1124–A, prescribed below. The original should accompany the United States bonds offered as security; the duplicate should be forwarded by the collector with the abatement claim to the Commissioner. If such bond and agreement is executed by a corporation a duly certified copy of the resolution of the board of directors, authorizing the execution should be attached. The United States Liberty bonds or other bonds of the United States, offered as security, shall at their par value be not less than the amount of the penal sum of the bond executed on form 1124–A, which shall be in double the amount of the tax covered by the abatement claim. The bonds so offered as security must be delivered to the Commissioner of Internal Revenue at the obligor's risk and expense. Coupon bonds can not safely be forwarded by registered mail unless insured by the obligor against risk of loss in transit. Registered bonds so offered as security must be registered in the name of the obligor and duly assigned to the Commissioner of Internal Revenue at or before the date of deposit with the Commissioner and need not be insured when forwarded by registered mail, unless the obligor so elects. In connection with effecting insurance of bonds shipped reference is made to article 187 (a) of Regulations No. 2 (Revised).

The Commissioner of Internal Revenue will issue a receipt in duplicate for United States bonds so deposited with him as security, the original of the receipt to be given to the obligor and the duplicate to be retained by the Commissioner for his files. Upon receipt by the Commissioner of the United States bonds so offered as security and upon satisfying himself as to their ownership and as to the sufficiency of the agreement for him to collect or sell, and in case of registered bonds as to the regularity of the assignments, he will approve the bond executed on form 1124–A, and deposit the United States bonds offered as security with the Treasurer of the United States, as provided in paragraph 7 of Department Circular No. 154 (1919), dated June 30, 1919, and the Treasurer of the United States will, as provided in said circular, give receipt therefor in duplicate describing the bonds so deposited, the original to be delivered to the Commissioner of Internal Revenue and the duplicate to be retained by the Treasurer for his files.

Bonds of the United States shall be returned to the obligor as soon as the security for the performance of such penal bond is no longer necessary. Registered bonds shall be reassigned to the owner when the liability is canceled.

These special instructions are prescribed for the guidance of collectors of internal revenue pursuant to the provisions of Treasury Department Circular No. 154 as to the acceptance of United States bonds in lieu of surety or sureties on penal bonds.

DEDUCTIONS ALLOWED: NONRESIDENT ALIEN INDIVIDUAL.

[Sec. 214.] (b) In the case of a nonresident alien individual the deductions allowed in paragraphs (1), (4), (7), (8), (9), (10), and (12), and clause (e) of paragraph (3), of subdivision (a) shall be allowed only if and to the extent that they are connected with income arising from a source within the United States; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

Art. 271. **Deductions allowed nonresident alien individuals.**—In the case of a nonresident alien individual the deduction for interest paid or accrued is proportionate to his income from sources within the United States (see paragraph (2) of subdivision (a) of section 214 of the statute); for losses incurred in any transaction entered into for profit, or arising from casualty or theft, is confined to transactions and property within the United States (5), (6); for charitable contributions excludes gifts to foreign corporations (11); and for business expenses, taxes imposed by a foreign country, losses in trade, bad debts, depreciation, amortization, depletion, and loss in inventory (1), (3), (4), (7), (8), (9), (10), and (12) is allowed only if and to the extent that it is connected with income arising from a source within the United States. See articles 91 and 311–316. As to deductions allowed foreign corporations, see section 234 (b) of the statute and article 573.

ITEMS NOT DEDUCTIBLE.

SEC. 215. That in computing net income no deduction shall in any case be allowed in respect of—

(a) Personal, living, or family expenses;

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

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

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

ART. 291. **Personal and family expenses.**—Insurance paid on a dwelling owned and occupied by a taxpayer is a personal expense and not deductible. Premiums paid for life insurance by the insured are not deductible. In the case of a professional man who rents a property for residential purposes, but incidentally receives there clients, patients, or callers in connection with his professional work (his place of business being elsewhere), no part of the rent is deductible as a business expense. If, however, he uses part of the house for his office, such portion of the rent as is properly attributable to such office is deductible. The father is legally entitled to the services of his minor children, and allowances which he gives them, whether said to be in consideration of services or otherwise, are not allowable deductions in his return of income. Alimony and an allowance paid under a separation agreement are not deductible from gross income. See article 73. The cost of the equipment of an army officer to the extent only that it is specially required by his profession and does not merely take the place of articles required in civilian life is deductible. Accordingly, the cost of a sword is an allowable deduction, but the cost of a uniform is not.

ART. 292. **Traveling expenses.**—Traveling expenses, as ordinarily understood, include railroad fares and meals and lodging. If the trip is undertaken for other than business purposes, such railroad fares are personal expenses and such meals and lodging are living expenses. If the trip is on business, the reasonable and necessary traveling expenses, including railroad fares, and meals and lodging in an amount in excess of any expenditures ordinarily required for such purposes when at home, become business instead of personal expenses. (*a*) If, then, an individual whose business requires him to travel receives a salary as full compensation for his services, without reimbursement for traveling expenses, or is employed on a commission basis with no expense allowance, his expenses for railroad fares, and expenses for meals and lodging in an amount in excess of any expenditures ordinarily required for such purposes when at home, are deductible from gross income. (*b*) If an individual receives a salary and is also repaid his actual traveling expenses, he shall include in gross income an amount thereof equal to the ordinary expenditures required for meals and lodging when at home, as such amount is held to be additional compensation to the taxpayer. (*c*) If an individual receives a salary and also an allowance for meals and lodging, as, for example, a per diem allowance in lieu of subsistence, any excess of the cost of such meals and lodging over the sum of the allowance and the ordinary expenditures required for such purposes when at home, is deductible, but any excess of the allowance over the difference between such expenses and such ordinary expenditures is taxable income. Congressmen and others who receive a mileage allowance for railroad fares should return as income any excess of such allowance over their actual expenses for such fares. A payment for the use of a sample room at a hotel for the display of goods is a business expense. This contemplates that only such expenses as are reasonable and necessary in the conduct of the business and directly attributable to it may be deducted. A taxpayer claiming the benefit of the deductions referred to herein must attach to his return a statement showing (1) the nature of the business in which engaged; (2) number of days away from home during the calendar year on account of business; (3) number of members in taxpayer's family dependent upon him for support; (4) average monthly expense incident to meals and lodging for entire family, including taxpayer himself when at home; (5) average monthly expense incident to meals and lodging when at home if taxpayer has no family; (6) total amount of expenses incident to meals and lodging while absent from home on business during taxable year; (7) total amount of excess expenditures incident to meals and lodging while traveling on business and claimed as a deduction; (8) total amount of other expenses incident to travel and claimed as a deduction.

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

ART. 293. **Capital expenditures.**—Amounts paid for increasing the capital value or for restoring the depreciated value of property are not deductible from gross income. See section 214 (a) (8) of the statute and article 161. Amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architect's services is part of the cost of the building. Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities are an offset against the selling price. Expenses of the administration of an estate, such as court costs, attorney's fees, and executor's commissions, are chargeable against the corpus of the estate and are not allowable deductions. Amounts to be assessed and paid under an agreement between bondholders or stockholders of a corporation, to be used in a reorganization of the corporation, are investments of capital and not deductible for any purpose in returns of income. See article 543. An assessment paid by a stockholder of a national bank on account of his statutory liability is similarly not deductible. As to items not deductible by corporations, see section 235 and articles 581 and 582.

ART. 294. **Premiums on business insurance.**—Premiums paid by a taxpayer on an insurance policy on the life of an officer, employee, or other individual financially interested in the taxpayer's business, for the purpose of protecting the taxpayer from loss in the event of the death of the officer or employee insured are not deductible from the taxpayer's gross income. If, however, the taxpayer is in no sense a beneficiary under such a policy, except as he may derive benefit from the increased efficiency of the officer or employee, premiums so paid are allowable deductions. See articles 33 and 105 to 108. In either case the proceeds of such policies paid upon the death of the insured may be excluded from gross income if the beneficiary is an individual, but must be included in gross income if the beneficiary is a corporation. See section 213(b) (1) and articles 72 and 541.

CREDITS ALLOWED.

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

(a) The amount received as dividends from a corporation which is taxable under this title upon its net income, and amounts received as dividends from a personal service corporation out of earnings or profits upon which income tax has been imposed by Act of Congress;

(b) The amount received as interest upon obligations of the United States and bonds issued by the War Finance Corporation, which is included in gross income under section 213;

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

(d) $200 for each person (other than husband or wife) dependent upon and receiving his chief support from the taxpayer, if such dependent person is under eighteen years of age or is incapable of self-support because mentally or physically defective.

(e) In the case of a nonresident alien individual who is a citizen or subject of a country which imposes an income tax, the credits allowed in subdivisions (c) and (d) shall be allowed only if such country allows a similar credit to citizens of the United States not residing in such country.

Art. 301. **Credits against net income.**—For the purpose of imposing the normal tax the taxpayer's net income as computed pursuant to section 212 of the statute and articles 21–26 is first reduced by the sum of the allowable credits. These include dividends (as defined in section 201 and articles 1541–1549) received other than from foreign corporations having no income from sources within the United States or domestic corporations not taxable upon their net incomes under Title II of the statute; interest not entirely exempt from tax received upon obligations of the United States and bonds of the War Finance Corporation; a personal exemption; and a credit for dependents. Consequently, the normal tax does not apply to dividends from domestic corporations taxable under Title II of the statute on their net incomes or from foreign corporations deriving income from sources within the United States, or to interest on any obligations of the United States. See section 213 (b) of the statute and articles 77–82 and 1131. For the purpose of imposing the surtax the taxpayer's net income is entitled to none of these credits. As to credits allowed corporations, see section 236 and article 591.

Art. 302. **Personal exemption of head of family.**—A head of a family is an individual who actually supports and maintains in one household one or more individuals who are closely connected with him by blood relationship, relationship by marriage, or by adoption, and whose right to exercise family control and provide for these dependent individuals is based upon some moral or legal obligation. In the absence of continuous actual residence together, whether or not a person with dependent relatives is a head of a family within the meaning of the statute must depend on the character of the separation. If a father is absent on business or at war, or a child or other dependent is away at school or on a visit, the common home being still maintained, the additional exemption applies. If, moreover, through force of circumstances a parent is obliged to maintain his dependent children with relatives or in a boarding house while he lives elsewhere, the additional exemption may still apply. If, however, without necessity the dependent continuously makes his home elsewhere, his benefactor is not the head of a family, irrespective of the question of support. A resident alien with children abroad is not thereby entitled to credit as the head of a family.

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

ART. 304. **Credit for dependents.**—A taxpayer receives a credit of $200 for each person (other than husband or wife), whether related to him or not and whether living with him or not, dependent upon and receiving his chief support from the taxpayer, provided the dependent is either (*a*) under eighteen or (*b*) incapable of self-support because defective. The credit is based upon actual financial dependency and not mere legal dependency. It may accrue to a taxpayer who is not the head of a family. But a father whose children receive half or more of their support from a trust fund or other separate source is not entitled to the credit.

ART. 305. **Date determining exemption.**—The status of the taxpayer on the last day of his taxable year determines his right to an additional exemption and to a credit for dependents. If then he is the head of a family, the personal exemption of $2,000 may be taken. If then he is the chief support of a dependent who is under eighteen years of age or incapable of self-support because mentally or physically defective, the credit of $200 may be taken. But an unmarried individual or a married individual not living with husband or wife, who during the taxable year has ceased to be the head of a family or to have dependents, is entitled only to the personal exemption of $1,000 allowed a single person. A husband and wife living together at the end of the taxable year may receive but one personal exemption of $2,000, divisible as they please, against their aggregate net income. If an individual dies during the taxable year, his executor or administrator in making a return for him is entitled to claim his full personal exemption according to his status at the time of his death. See also section 219 (c) of the statute and articles 346 and 421. If a husband or wife so dies and the joint personal exemption is used by the executor or administrator in making a return for the decedent, an undiminished personal exemption according to the status of the survivor at the end of the taxable year may be claimed in the survivor's return. If a taxpayer makes a return for a period other than a taxable year, the last day of such period shall be treated as the last day of the taxable year for the purpose of this article. See section 226 and articles 431 and 1013.

ART. 306. **Credits to nonresident alien individual.**—A nonresident alien individual, similarly to a citizen or resident, is entitled for the purpose of the normal tax to credit dividends from domestic or resident foreign corporations, interest on obligations of the United States, a personal exemption, and $200 for each dependent, except that if he is a citizen or subject of a country which imposes an income tax a personal exemption or credit for dependents is allowed him "only if such country allows a similar credit to citizens of the United States not residing in such country." "If such country allows a similar credit" means if such country in imposing its income tax allows a personal exemption or a credit for dependents, as the case may be, and allows it without discrimination to citizens of the United States not residing in such country. For the meaning of "country" see article 382. To satisfy the requirement of a similar credit it is not necessary that the personal exemption or credit for dependents, as the case may be, should be the same as that allowed by the United States statute. The status as to residence of an alien individual on the last day of his taxable year determines his right to be treated as a resident or as a nonresident for such year.

ART. 307. **When nonresident alien individual entitled to personal exemption.**—(*a*) The following is an incomplete list of countries which either impose no income tax or in imposing an income tax allow both a personal exemption and a credit for dependents which satisfy the similar credit requirement of the statute: Argentina, Bahama, Belgium, Bermuda, Bolivia, Bosnia, Brazil, Bukowina, Bulgaria, Canada, Carinthia, Carniola, China, Chile, Cuba, Czechoslovakia, including Bohemia, Moravia, and Slovakia, Dalmatia, Denmark, Ecuador, Egypt, France, Galicia, Germany, (applicable to 1920 and subsequent years), Goritz, Gradisca, Greece, Guatemala, Herzegovina, Istria, Jamaica, Lithuania, Lower Austria, Luxemburg, Malta, Mexico, Montenegro, Morocco, Newfoundland, Nicaragua, Norway, Panama, Paraguay, Persia, Peru, Porto Rico, Portugal, Roumania, Russia (including Poles owing allegiance to Russia), Salzburg, Santo Domingo, Serbia, Siam, Silesia, Styria, Spain, Switzerland, Trieste, Tyrol, Upper Austria, Union of South Africa, Venezuela. (*b*) The following is an incomplete list of countries which in imposing an income tax allow a personal exemption which satisfies the similar credit requirement of the statute, but do not allow a credit for dependents: Bachka, Banat of Temesvar, Croatia, Finland, India, Italy, Salvador, Slavonia, Transylvania. (*c*) The following is an incomplete list of countries which in imposing an income tax do not allow to citizens of the United States not residing in such country either a personal exemption or a credit for dependents and, therefore, fail entirely to satisfy the similar credit requirements of the statute: Australia, Costa Rica, Great Britain and Ireland, Japan, The Netherlands, New Zealand, Sweden. The former names of certain of these territories are here used for convenience, in spite of an actual or possible change in name or sovereignty. A nonresident alien individual who is a citizen or subject of any country in the first list is entitled for the purpose of the normal tax to such credit for a personal exemption and for dependents as his family status may warrant. If he is a citizen or subject of any country in the second list he is entitled to a credit for personal exemption, but to none for dependents. If he is a citizen or subject of any country in the third list he is not entitled to credit for either a personal exemption or for dependents. If he is a citizen or subject of a country which is in none of the lists, then to secure credit for either a personal exemption or for dependents he must prove to the satisfaction of the Commissioner that his country does not impose an income tax or that in imposing an income tax it grants the similar credit required by the statute.

NONRESIDENT ALIENS—ALLOWANCE OF DEDUCTIONS AND CREDITS.

SEC. 217. That a nonresident alien individual shall receive the benefit of the deductions and credits allowed in this title only by filing or causing to be filed with the collector a true and accurate return of his total income received from all sources corporate or otherwise in the United States, in the manner prescribed by this title, including therein all the information which the Commissioner may deem necessary for the calculation of such deductions and credits: *Provided*, That the benefit of the credits allowed in subdivisions (c) and (d) of section 216 may, in the discretion of the Commissioner, and except as otherwise provided in subdivision (e) of that section, be received by filing a claim therefor with the withholding agent. In case of failure to file a return, the collector shall collect the tax on such income, and all property belonging to such nonresident alien individual shall be liable to distraint for the tax.

ART. 311. **Allowance of deductions and credits to nonresident alien individual.**—Unless a nonresident alien individual shall render a return of income as required in article 404, the tax shall be collected on the basis of his gross income (not his net income) from sources within the United States. Where a nonresident alien has various sources of income within the United States, so that from any one source or from all sources combined the amount of income shall call for the assessment of a surtax, and a return of income shall not be filed by him or on his behalf, the Commissioner will cause a return of income to be made and include therein the income of such nonresident alien from all sources concerning which he has information, and he will assess the tax and collect it from one or more of the sources of income within the United States of such nonresident alien, without allowance for deductions or credits. The benefit of the credits allowed against net income for the purpose of the normal tax may not be received by a nonresident alien by filing a claim with the withholding agent, but only by claiming them upon filing a return of income, except as permitted in article 316. See section 216 of the statute and articles 306 and 307.

ART. 312. **Who is a nonresident alien individual.**—"Nonresident alien individual" means an individual (*a*) whose residence is not within the United States and (*b*) who is not a citizen of the United States. Any alien living in the United States who is not a mere transient is a resident of the United States for purposes of the income tax. Whether he is a transient or not is determined by his intentions with regard to his stay. If he lives in the United States and has no definite intention as to his stay, he is a resident. The best evidence of his intention is afforded by the conduct, acts, and declarations of the alien. The typical transient is one who stops for a short time in the course of a journey through the United States, sometimes performing labor, sometimes not, or one who enters the United States intending only to stop long enough to carry out some purpose, object or plan not involving an extended stay. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient.

ART. 312(a). **Alien seamen, when to be regarded as residents.**—In order to determine whether an alien seaman is a resident within the meaning of the income-tax law, it is necessary to decide whether the presumption of nonresidence is overcome by facts showing that he has established a residence in the territorial United States, which consists of the States, the District of Columbia, and the Territories of Hawaii and Alaska, and excludes other places. Residence may be established on a vessel regularly engaged in coastwise trade, but the mere fact that a sailor makes his home on a vessel flying the United States flag and engaged in foreign trade is not sufficient to establish residence in the United States, even though the vessel, while carrying on foreign trade, touches at American ports. An alien seaman may acquire an actual residence in the territorial United States within the rules laid down in article 312, although the nature of his calling requires him to be absent from the place where his residence is established for a long period. An alien seaman may acquire such a residence at a sailor's boarding house or hotel, but such a claim should be carefully scrutinized in order to make sure that such residence is bona fide. The filing of form 1078 (revised), or taking out first-citizenship papers, is proof of residence in the United States from the time the form is filed or the papers taken out, unless rebutted by other evidence showing an intention to be a transient. The fact that a head tax has been paid on behalf of an alien seaman entering the United States is no evidence that he has acquired residence, because the head tax is payable unless the alien who is entering the country is merely in transit through the country. An alien may remain a nonresident although he is not in transit through the country. As to when the wages of alien seamen are subject to tax, see article 92 (a).

Art. 313. **Proof of residence of alien.**—An alien's statements as to his intention with regard to residence are not conclusive, but when unequivocal will determine the question of his intention, unless his conduct, acts, or other surrounding circumstances contradict the statements. It sometimes occurs that an alien who genuinely intends his stay to be transient may put off his departure from time to time by reason of changed conditions, remaining a transient though living in the United States for a considerable time. The fact that an alien's family is abroad does not necessarily indicate that he is a transient rather than a resident. An alien who enters this country intending to make his home in a foreign country as soon as he has accumulated a sum of money sufficient to provide for his journey abroad is to be considered a transient, provided his expectation in this regard may reasonably, considering the rate of his saving, be fulfilled within a comparatively short time.

Art. 314. **Loss of residence by alien.**—It will be presumed that an alien who has established a residence in the United States, as outlined above, continues to be a resident until he or his family evidence an intention to change their residence to another country by starting to remove. Thus, alien residents who, following the armistice agreement of November 11, 1918, take steps toward returning to their native countries, as by applying for passports, may for the purpose of withholding be regarded as residents for that portion of the taxable year which elapsed up to the time such step was taken. But the status of the alien on the last day of his taxable year or period determines his liability to tax for such year or period as a resident or nonresident. See articles 305 and 306.

Art. 315. **Duty of employer to determine status of alien employee.**—Aliens employed in the United States are prima facie regarded as nonresidents. If wages are paid without withholding the tax, except as permitted in the following article, the employer should be provided with written proof of facts which overcome the presumption that such alien is a nonresident. Such facts include the following: (*a*) If an alien has been living in the United States for as much as one year immediately prior to the time he entered the employment of the withholding agent, or if he has been regularly employed by a resident individual or corporation in the same county for as much as three months immediately prior to any payment by the employer, he may be treated as a resident in the absence of facts known to the employer showing that he is in fact a transient, such as one of the types mentioned under article 312. The facts with regard to the length of time the alien has thus lived in the country or county and has been so regularly employed may be established by the certificate of the alien. (*b*) The employer may also obtain evidence to overcome the prima facie presumption of nonresidence by securing from the alien form 1078 (revised) or an equivalent certificate of the alien establishing residence. Having secured such evidence from the alien, the employer may rely thereon unless the statement of the alien was false and the employer has reasonable cause to believe it false, and may continue to rely thereon until the alien ceases to be a resident under the provisions of article 314. An employer who seeks to account for failure to withhold in the past, if he did not at the time secure from 1078 (revised) or its equivalent, is permitted to prove the former status of the alien by any material evidence.

ART. 316. **Allowance of personal exemption to nonresident alien employee.**—A nonresident alien employee, provided he is entitled under section 216 of the statute and articles 301–307 to credit for a personal exemption or for dependents or both, may claim the benefit of such credit by filing with his employer form 1115, duly filled out and executed under oath. See particularly the lists of foreign countries in article 307. On the filing of such a claim the employer shall examine it. If on such examination it appears that the claim is in due form, that it contains no statement which to the knowledge of the employer is untrue, that such employee on the face of the claim is entitled to credit, and that such credit has not yet been exhausted, such employer need not until such credit be in fact exhausted withhold any tax from payments of salary or wages made to such employee. Every employer with whom affidavits of claim on form 1115 are filed by employees shall preserve such affidavits until the following calendar year, and shall then file them, attached to his annual withholding return on form 1042 (revised), with the collector on or before March 1. In case, however, when the following calendar year arrives such employer has no withholding to return, he shall forward all such affidavits of claim directly to the Commissioner, with a letter of transmittal, on or before March 15. Where any tax is withheld the employer in every instance shall show on the pay envelope or shall furnish some other memorandum showing the name of the employee, the date and the amount withheld. This article applies only to payments of compensation by an employer to an employee. See further section 221 and articles 361–376.

PARTNERSHIPS AND PERSONAL SERVICE CORPORATIONS.

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

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

(b) If a fiscal year of a partnership ends during a calendar year for which the rates of tax differ from those for the preceding calendar year, then (1) the rates for such preceding calendar year shall apply to an amount of each partner's share of such partnership net income equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year, and (2) the rates for the calendar year during which such fiscal year ends shall apply to the remainder.

(c) In the case of an individual member of a partnership which makes return for a fiscal year beginning in 1917 and ending in 1918, his proportionate share of any excess-profits tax imposed upon the partnership under the Revenue Act of 1917 with respect to that part of such fiscal year falling in 1917, shall, for the purpose of determining the tax imposed by this title, be credited against that portion of the net income embraced in his personal return for the taxable year 1918 to which the rates for 1917 apply.

(d) The net income of the partnership shall be computed in the same manner and on the same basis as provided in section 212 except that the deduction provided in paragraph (11) of subdivision (a) of section 214 shall not be allowed.

(e) Personal service corporations shall not be subject to taxation under this title, but the individual stockholders thereof shall be taxed in the same manner as the members of partnerships. All the provisions of this title relating to partnerships and the members thereof shall so far as practicable apply to personal service corporations and the stockholders thereof: *Provided*, That for the purpose of this subdivision amounts distributed by a personal service corporation during its taxable year shall be accounted for by the distributees; and any portion of the net income remaining undistributed at the close of its taxable year shall be accounted for by the stockholders of such corporation at the close of its taxable year in proportion to their respective shares.

ART. 321. **Partnerships.**—Partnerships as such are not subject to taxation under the statute, but are required to make returns of income. See section 224 of the statute and articles 411 and 412. Individuals carrying on business in partnership are, however, taxable upon their distributive shares of the net income of such partnerships, whether distributed or not, and are required to include such distributive shares in their returns. The net income of a partnership shall be computed in the same manner and on the same basis as the net income of an individual, except that the deduction of contributions or gifts is not permitted. See section 212 and articles 21–26. As to the excess profits tax on partnerships with fiscal years ending in 1918 see section 335 (c).

ART. 322. **Distributive shares of partners.**—The distributive share of the net income of a partnership which a partner is required to include in his return is his proportionate share of the net income of the partnership, either (*a*) for the taxable year upon the basis of which the partner's net income is computed, or (*b*), if the partner's net income is computed upon the basis of a taxable year different from that upon the basis of which the net income of the partnership is computed, for the taxable year of the partnership ending within the taxable year upon the basis of which the partner's net income is computed. Amounts earned and distributed to a partner by a partnership after the end of its taxable year and before the end of his corresponding taxable year should be accounted for both by the partnership and by the partner in their returns for their next succeeding taxable years.

ART. 323. **Credits allowed partners.**—In addition to the credits ordinarily allowed to an individual, a partner is entitled to the following credits: (*a*) a credit against net income for the purpose of the normal tax only of his proportionate share of such dividends from corporations subject to tax and of such interest not entirely exempt from tax upon obligations of the United States and bonds of the War Finance Corporation as are received by the partnership; and (*b*) a credit against income tax of the partner's proportionate share of any income, war profits, and excess profits taxes of the partnership paid or accrued during the taxable year to a foreign country upon income derived from sources therein, or to any possession of the United States, subject to the limitations of section 222 of the statute. See section 216 and articles 301 and 381–385.

ART. 324. **Taxation of partners in partnership with fiscal year ending in 1918.**—If the fiscal year of a partnership began in the calendar year 1917 and ended in the calendar year 1918, the rates of tax for the calendar year 1917 apply to the amount of each partner's distributive share of the net income of the partnership for such fiscal year attributable to the calendar year 1917, and the rates for the calendar year 1918 to the amount of each partner's distributive share of such net income of the partnership attributable to the calendar year 1918. (*a*) The amount of each partner's distributive share of the net income of the partnership for such fiscal year attributable to the calendar year 1917 is found by determining the net income of the partnership for its entire fiscal year in accordance with the law applicable to the calendar year 1917 (see Title I of the Revenue Act of 1916 and Titles I and XII of the Revenue Act of 1917) and the distributive share thereof of each partner, and then taking such proportion of that distributive share as the part of the fiscal year falling within the calendar year 1917 bears to the full fiscal year. (*b*) The amount of each partner's distributive share of the net income of the partnership for such fiscal year attributable to the calendar year 1918 is found by determining the net income of the partnership for its entire fiscal year in accordance with the law applicable to the calendar year 1918 and the distributive share thereof of each partner, and then taking such proportion of that distributive share as the part of the fiscal year falling within the calendar year 1918 bears to the full fiscal year. See section 205 (c) of the statute and article 1621.

ART. 325. **Application of different tax rates in the case of fiscal year of partnership ending in 1918.**—Any deductions, exemptions, or credits to which the partner in a partnership with a fiscal year ending in 1918 is entitled shall first be applied against his income subject to the rates for the calendar year 1918, unless of a kind plainly and properly chargeable against income taxable at the rates for the calendar year 1917. The proportionate share of a partner of any excess profits tax imposed upon the partnership under the Revenue Act of 1917 with respect to that part of the fiscal year falling within the calendar year 1917 is plainly and properly chargeable against income taxable at the rate for that year and shall be credited against such income of the partner. In determining the rates of tax applicable to the amounts of the distributive shares of the partners attributable to the calendar years 1917 and 1918, respectively, the amounts subject to the rates for the calendar year 1918 shall be placed in the lower brackets of the rate schedule provided in the present statute and the amounts attributable to the calendar year 1917 in the next higher brackets of the rate schedule applicable to that year. See section 206 of the statute and article 1641, and also section 1 of Title I of the Revenue Act of 1916 and sections 1 and 2 of Title I of the Revenue Act of 1917.

ART. 326. **Taxation of partners in partnership with fiscal year ending in 1919.**—If the fiscal year of a partnership began in the calendar year 1918 and ended in the calendar year 1919, the rates of tax for the calendar year 1918 apply to the amount of each partner's distributive share of the net income of the partnership for such fiscal year attributable to the calendar year 1918, and the rates for the calendar year 1919 to the amount of each partner's distributive share of such net income of the partnership attributable to the calendar year 1919. (*a*) The amount of each partner's distributive share of the net income of the partnership for such fiscal year attributable to the calendar year 1918 is found by determining the net income of the partnership for its entire fiscal year in accordance with the law applicable to the calendar year 1918 and the distributive share thereof of each partner, and then taking such proportion of that distributive share as the part of the fiscal year falling within the calendar year 1918 bears to the full fiscal year. (*b*) The amount of each partner's distributive share of the net income of the partnership for such fiscal year attributable to the calendar year 1919 is found by determining the net income of the partnership for its entire fiscal year in accordance with the law applicable to the calendar year 1919 and the distributive share thereof of each partner, and then taking such proportion of that distributive share as the part of the fiscal year falling within the calendar year 1919 bears to the full fiscal year. See section 205 (c) of the statute and article 1621.

ART. 327. **Application of different tax rates in the case of fiscal year of partnership ending in 1919.**—Any deductions, exemptions or credits to which the partner in a partnership with a fiscal year ending in 1919 is entitled shall first be applied against his income subject to the rates for the calendar year 1919, unless of a kind plainly and properly chargeable against income taxable at the rates for the calendar year 1918. In determining the rates of tax applicable to the amounts of the distributive shares of the partners attributable to the calendar years 1918 and 1919, respectively, the amounts subject to the rates for the calendar year 1919 shall be placed in the lower brackets of the rate schedule provided in the statute, and the amounts attributable to the calendar year 1918 in the next higher brackets of the rate schedule applicable to that year. See section 206 of the statute and article 1641.

ART. 328. **Personal service corporations.**—Personal service corporations are defined in section 200 of the statute. See articles 1523–1532. Such corporations are not subject to tax as corporations, unless they make returns for fiscal years beginning in 1917, but they are required to make returns of income. See sections 231, 239, and 304 of the statute and the articles thereunder. An individual stockholder of a personal service corporation is, however, subject to tax much like a member of a partnership upon his distributive share of the net income of the corporation. The net income of a personal service corporation, as in the case of a partnership, shall be computed in the same manner and on the same basis as the net income of an individual, except that the deduction of contributions or gifts is not permitted. See section 212 and articles 21–26. A corporation which is taxable under section 303 is not a personal service corporation and its stockholders are taxed like stockholders in an ordinary corporation.

ART. 329. **Personal service corporation with fiscal year ending in 1918.**—If the fiscal year of a personal service corporation began in the calendar year 1917 and ended in the calendar year 1918, it is subject to tax as a corporation for the part of such fiscal year which falls within the calendar year 1917. The amount for which such a corporation is liable is such proportion of the tax for the entire fiscal year computed in accordance with Title I of the Revenue Act of 1916 as amended and with Title I of the Revenue Act of 1917 as the portion of such fiscal year falling within the calendar year 1917 is of the entire period. An amount previously paid by the corporation on account of the income tax for such fiscal year shall be credited toward the payment of the tax for the portion of the fiscal year falling within the calendar year 1917, and any excess shall be credited or refunded in accordance with the provisions of section 252 of the statute. See section 205 (a) and article 1621. As to the excess profits tax see section 335 (c).

ART. 330. **Distributive shares of stockholders in personal service corporation.**—A stockholder of a personal service corporation is required to include in his gross income for the taxable year (*a*) any dividends paid by the corporation in such year out of earnings or profits accumulated since February 28, 1913, and before January 1, 1918; (*b*) his share of any distribution made by the corporation in such year out of earnings or profits accumulated since December 31, 1917, and since the close of its taxable year ending with or during his next preceding taxable year; and (*c*) his distributive share of the undistributed net income of the corporation for its taxable year ending with or during his taxable year, provided he was at the close of its taxable year a stockholder in the corporation, notwithstanding he might since have ceased to be a stockholder. See section 201 of the statute and articles 1541–1543. In the case of personal service corporations with taxable years other than the calendar year, however, such distributive shares or distributions may be subject to different rates of tax.

ART. 331. **Credits allowed stockholders of personal service corporation.**—A stockholder of a personal service corporation is entitled to credit for the purpose of the normal tax only for amounts received in distribution of earnings or profits of the corporation accumulated since February 28, 1913, and prior to January 1, 1918. See sections 201 and 216 of the statute and articles 1541 and 301. In addition to the credits ordinarily allowed to an individual a stockholder of a personal service corporation is entitled to the following credits: (*a*) a credit against net income for the purpose of the normal tax only of his proportionate share of such dividends from a corporation subject to tax and of such interest not entirely exempt from tax upon obligations of the United States and bonds of the War Finance Corporation as are received by the personal service corporation, and (*b*) a credit against income tax of the stockholder's proportionate share of income, war profits and excess profits taxes of the personal service corporation paid or accrued during the taxable year to a foreign country upon income derived from sources therein, or to any possession of the United States, subject to the limitations of section 222 of the statute. See articles 381–385.

ART. 332. **Taxation of stockholders of personal service corporation with fiscal year ending in 1918.**—A stockholder of a personal service corporation with a fiscal year beginning in 1917 and ending in 1918 is taxed at the rates for the calendar year 1918 (*a*) on any dividends received in such calendar year out of earnings or profits accumulated since February 28, 1913, and before January 1, 1918 (except as provided under (*d*) below); see sections 216 (a) and 201 (a); (*b*) on any distribution made in such calendar year out of earnings or profits accumulated since December 31, 1917; and (*c*) on his distributive share of the undistributed net income of the corporation for its fiscal year attributable to the calendar year 1918. (*d*) On his distributive share of the undistributed net income of the corporation for its fiscal year attributable to the calendar year 1917, however, the stockholder is liable to surtax at the rates for the calendar year 1917, but to no normal tax, and any distribution by the corporation subsequently to the close of its fiscal year out of such undistributed net income so taxed to the stockholders is free from any tax. The part of the net income of a corporation for its fiscal year attributable to the calendar year 1918 is found by determining the net income of the corporation for its fiscal year in the same manner as if the fiscal year were the calendar year 1918, and then taking the proportion thereof which the part of such fiscal year falling within such calendar year bears to the full fiscal year. The part of the net income of a corporation for its fiscal year attributable to the calendar year 1917 is found by determining the net income of the corporation for its fiscal year in accordance with the law applicable to the calendar year 1917, and then taking the proportion thereof which the part of such fiscal year falling within the calendar year 1917 bears to the full fiscal year. See section 205 (*c*) of the statute and article 1621.

ART. 333. **Application of different tax rates in the case of fiscal year of personal service corporation ending in 1918.**—Any deductions, exemptions or credits to which the stockholder of a personal service corporation with a fiscal year ending in 1918 is entitled shall first be applied against his income subject to the rates for the calendar year 1918, unless of a kind plainly and properly chargeable against income taxable at the rates for the calendar year 1917. The proportionate share of a stockholder of any excess profits tax imposed upon the corporation under the Revenue Act of 1917 with respect to that part of the fiscal year falling within the calendar year 1917 is plainly and properly chargeable against income taxable at the rates for that year and shall be credited against such income of the stockholder. In determining the rates of tax applicable to the amounts of the distributive shares of the stockholders attributable to the calendar years 1917 and 1918, respectively, the amounts subject to the rates for the calendar year 1918 shall be placed in the lower brackets of the rate schedule provided in the present statute and the amounts attributable to the calendar year 1917 in the next higher brackets of the rate schedule applicable to that year. See section 206 of the statute and article 1641, and also section 1 of Title I of the Revenue Act of 1916 and sections 1 and 2 of Title I of the Revenue Act of 1917.

ART. 334. **Taxation of stockholders of personal service corporation with fiscal year ending in 1919.**—Such part of a stockholder's distributive share of the net income of a personal service corporation for its fiscal year ending in 1919 as is attributable to the calendar year 1919 is taxable at the rates for such calendar year, and such part of such distributive share as is attributable to the calendar year 1918 is taxable at the rates for such calendar year. The part of a stockholder's distributive share of the net income of a corporation for its fiscal year attributable to the calendar year 1919 is found by determining his distributive share of the net income of the corporation for its fiscal year, whether distributed or not, in the same manner as if the fiscal year were the calendar year 1919, and then taking the proportion thereof which the part of such fiscal year falling within such calendar year bears to the full fiscal year. The part of a stockholder's distributive share of the net income of a corporation for its fiscal year attributable to the calendar year 1918 is found by determining his distributive share of the net income of the corporation for its fiscal year, whether distributed or not, in the same manner as if the fiscal year were the calendar year 1918, and then taking the proportion thereof which the part of such fiscal year falling within such calendar year bears to the full fiscal year. The stockholder is also liable to tax on dividends received out of earnings or profits accumulated since February 28, 1913, and before January 1, 1918. See sections 201, 205 (c), and 216 (a) of the statute and articles 1541–1543 and 1621.

ART. 335. **Application of different tax rates in the case of fiscal year of personal service corporation ending in 1919.**—Any deductions, exemptions, or credits to which the stockholder of a personal service corporation with a fiscal year ending in 1919 is entitled shall first be applied against his income subject to the rates for the calendar year 1919, unless of a kind plainly and properly chargeable against income taxable at the rates for the calendar year 1918. In determining the rates of tax applicable to the amounts of the distributive shares of the stockholders attributable to the calendar years 1918 and 1919, respectively, the amounts subject to the rates for the calendar year 1919 shall be placed in the lower brackets of the rate schedule provided in the statute and the amounts attributable to the calendar year 1918 in the next higher brackets of the rate schedule applicable to that year. See section 206 of the statute and article 1641.

ESTATES AND TRUSTS.

SEC. 219. (a) That the tax imposed by sections 210 and 211 shall apply to the income of estates or of any kind of property held in trust, including—

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

(2) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests;

(3) Income held for future distribution under the terms of the will or trust; and

(4) Income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals, and the income collected by a guardian of an infant to be held or distributed as the court may direct.

(b) The fiduciary shall be responsible for making the return of income for the estate or trust for which he acts. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that there shall also be allowed as a deduction (in lieu of the deduction authorized by paragraph (11) of subdivision (a) of section 214) any part of the gross income which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid to or permanently set aside for the United States, any State. Territory, or any political subdivision thereof, or the District of Columbia, or any corporation organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual; and in cases under paragraph (4) of subdivision (a) of this section the fiduciary shall include in the return a statement of each beneficiary's distributive share of such net income, whether or not distributed before the close of the taxable year for which the return is made.

(c) In cases under paragraph (1), (2), or (3) of subdivision (a) the tax shall be imposed upon the net income of the estate or trust and shall be paid by the fiduciary, except that in determining the net income of the estate of any deceased person during the period of administration or settlement there may be deducted the amount of any income properly paid or credited to any legatee, heir or other beneficiary. In such cases the estate or trust shall, for the purpose of the normal tax, be allowed the same credits as are allowed to single persons under section 216.

(d) In cases under paragraph (4) of subdivision (a), and in the case of any income of an estate during the period of administration or settlement permitted by subdivision (c) to be deducted from the net income upon which tax is to be paid by the fiduciary, the tax shall not be paid by the fiduciary, but there shall be included in computing the net income of each beneficiary his distributive share, whether distributed or not, of the net income of the estate or trust for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the estate or trust is computed, then his distributive share of the net income of the estate or trust for any accounting period of such estate or trust ending within the fiscal or calendar year upon the basis of which such beneficiary's net income is computed. In such cases the beneficiary shall, for the purpose of the normal tax, be allowed as credits in addition to the credits allowed to him under section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as are received by the estate or trust.

ART. 341. **Estates and trusts.**—While certain estates and trusts are subject to tax as such and others are not, the fiduciary in every case is required to make a return of income. See section 225 of the statute and articles 421–425. The net income of an estate or trust shall be computed in the same manner and on the same basis as the net income of an individual, except that in place of the deduction allowed individuals of certain gifts or contributions there may be deducted from the gross income any part of it which during the taxable year is pursuant to the will or trust deed paid to or permanently set aside for the United States, a State, a Territory, or any political subdivision thereof, the District of Columbia, or any corporation or association of the kind described in section 231 (6) of the statute and article 517. See section 212 and articles 21–26. The income of a revocable trust must be included in the gross income of the grantor.

ART. 342. **Estates and trusts taxed to fiduciary.**—In the case of (*a*) estates of decedents before final settlement and of (*b*) trusts, whether created by will or deed, for accumulation of income, whether for unascertained persons or persons with contingent interests or otherwise, the income is taxed to the fiduciary as to any single individual, except that from the income of a decedent's estate there may first be deducted any amount of income properly paid or credited to a beneficiary. See section 200 of the statute and articles 1521 and 1522. Where under the terms of the will or deed the trustee may in his discretion distribute the income or accumulate it, the income is taxed to the trustee, irrespective of the exercise of his discretion. The imposition of the tax is not affected by the fact that an ultimate beneficiary may be a person exempt from tax. A statutory allowance paid a widow out of the corpus of the estate is not deductible from gross income. As an intestate's real estate does not pass to his administrator, upon a sale by the heirs, whether before or after settlement of the estate, each heir is taxed individually on any profit derived.

ART. 343. **Decedent's estate during administration.**—The "period of administration or settlement of the estate" is the period required by the executor or administrator to perform the ordinary duties pertaining to administration, in particular the collection of assets and the payment of debts and legacies. It is the time actually required for this purpose, whether longer or shorter than the period specified in the local statute for the settlement of estates. Where an executor, who is also named as trustee, fails to obtain his discharge as executor, the period of administration continues up to the time when the duties of administration are complete and he actually assumes his duties as trustee, whether pursuant to an order of the court or not. No taxable income is realized from the passage of property to the executor or administrator on the death of the decedent, even though it may have appreciated in value since the decedent acquired it. In the event of delivery of property in kind to a legatee or distributee, no income is realized. Where, however, the executor sells property of the estate for more than its value at the death of the decedent, the excess is income taxable to the estate. See article 1562.

ART. 344. **Incidence of tax on estate or trust.**—Liability for payment of the tax attaches to the person of an executor or administrator up to and after his discharge, where prior to distribution and discharge he had notice of his tax obligations or failed to exercise due diligence in determining whether or not such obligations existed. Liability for the tax also follows the estate itself, and when by reason of the distribution of the estate and the discharge of the executor or administrator it appears that collection of the tax can not be made from the executor or administrator, the legatees or distributees must account for their proportionate share of the tax due and unpaid. The same considerations apply to other trusts. Where the tax has been paid on the net income of an estate or trust by the fiduciary, such income is free from tax when distributed to the beneficiaries.

ART. 345. **Estates and trusts taxed to beneficiaries.**—In the case of (*a*) a trust the income of which is distributable periodically, (*b*) an ordinary guardianship of a minor, and (*c*) an estate of a decedent before final settlement as to any income properly paid or credited as such to a beneficiary, the income is taxable directly to the beneficiary or beneficiaries. Each such beneficiary must include in his return his distributive share of the net income, even though not yet paid him, but if the taxable year on the basis of which he makes his returns fails to coincide with the annual accounting period of the estate or trust, then he need only include in his return his distributive share for such accounting period ending within his taxable year. The regulations governing partnerships are generally applicable to such an estate or trust. See articles 321–327.

ART. 346. **Credits to trust or beneficiary.**—(*a*) In the case of an estate or trust taxed to the fiduciary it is allowed the same credits against net income as a single person, including a personal exemption of $1,000, but no credit for dependents. (*b*) In the case of an estate or trust taxed to the beneficiaries each beneficiary is allowed for the purpose of the normal tax, in addition to his individual credits, his proportionate share of such dividends from domestic and resident foreign corporations and of such interest not entirely exempt from tax upon obligations of the United States and bonds of the War Finance Corporation as are received by the estate or trust. Each beneficiary is entitled to but one personal exemption, no matter from how many trusts he may receive income. See section 216 of the statute and articles 301–307.

ART. 347. **Estates and trusts which can not be treated as a unit.**—In the case of certain estates and trusts it is recognized that the estate or trust can not be treated as a unit for income tax purposes and may represent an aggregate of distinct interests to all of which the fiduciaries are responsible; in such cases the procedure stated in this article should govern. The following are recognized as cases which can not be treated as a unit and must, therefore, be governed by this article: (*a*) When there is income distributable periodically and also income which is to be accumulated in trust, held for future distribution, or added to the corpus; (*b*) when there is income distributable periodically and also income (according to the Federal income tax statutes and regulations) which is not distributable periodically under State law, e. g., gains from sale of capital assets; (*c*) when there is income distributable periodically and deductions (according to Federal income tax statutes and regulations) which are not deductible under State law from the distributable income, e. g., losses from the sale of capital assets, depletion, depreciation.

In ascertaining whether an estate or trust comes within any one of the cases just enumerated, the provisions of the Federal statutes and regulations—rather than the provisions of the will or trust and the provisions of State laws—shall determine what items constitute taxable gross income or allowable deductions; the provisions of the will or trust and of State laws shall determine the allocation of items of gross income or deduction; that is, to which of the different interests making up the whole such items shall be charged or allowed. In cases which are to be treated under this article, the items of gross income and deduction as determined by the Federal income tax statutes and regulations must be scrutinized and classified in accordance with the provisions of the will or trust or rules of local law into two classes, one subject to the procedure specified in subdivision (*c*) of section 219, and the other to the procedure specified in subdivision (*d*) of section 219. The result will be that the beneficiary to whom income is to be distributed periodically must include in computing his net income the amount actually distributable to him (except exempt income) even though the aggregate of the distributive shares should be larger than the net income of the estate or trust computed as a unit. Any gain, profit, or income which is not periodically distributable, must be included in computing the net income of the estate or trust so that the fiduciary will pay the tax upon any excess of the net income of the estate or trust computed as a unit over the aggregate distributive shares.

For example, a trust is created the income of which is distributable periodically for the life of the beneficiary, the remainder over to others. The trust has the following items of income: Rent, $3,000; interest, $2,000; gain on sale of capital assets, $1,500; cash dividend, $1,000; and deductions, general expenses (all deductible from distributable income), $700; depreciation, $300; loss on sale of capital assets, $3,000. Under the terms of the trust $5,300 will be distributed to the beneficiary, viz, rent, $3,000; plus interest, $2,000; plus dividend, $1,000; less general expenses, $700. The gain and loss on the sale of capital assets will be considered capital items affecting the corpus only, and the items of depreciation will not affect the amount to be distributed, there being no rule of State law or provision of the trust requiring this deduction from distributable income. In such a case the fiduciary must report on form 1041 showing a net income for the trust of $3,500, and must show as the distributive share of the beneficiary the $5,300 to which he is entitled. The beneficiary must account for the amount actually distributable to him as income, viz, $5,300, as provided in section 219 (*d*) and will be entitled to a credit of $1,000 on account of the dividends in computing the normal tax, but not to any deduction on account of depreciation or capital losses.

If there had been no loss on the sale of capital assets so that the net income of the estate or trust was $6,500, form 1041 should show the distributive share of the beneficiary as $5,300, and the distributive share of the fiduciary as $1,200; and the fiduciary should file a separate return on form 1040 A, reporting $1,200 for taxation.

PROFITS OF CORPORATIONS TAXABLE TO STOCKHOLDERS.

SEC. 220. That if any corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its stockholders or members through the medium of permitting its gains and profits to accumulate instead of being divided or distributed, such corporation shall not be subject to the tax imposed by section 230, but the stockholders or members thereof shall be subject to taxation under this title in the same manner as provided in subdivision (e) of section 218 in the case of stockholders of a personal service corporation, except that the tax imposed by Title III shall be deducted from the net income of the corporation before the computation of the proportionate share of each stockholder or member. The fact that any corporation is a mere holding company, or that the gains and profits are permitted to accumulate beyond the reasonable needs of the business, shall be prima facie evidence of a purpose to escape the surtax; but the fact that the gains and profits are in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the tax in such case unless the Commissioner certifies that in his opinion such accumulation is unreasonable for the purposes of the business. When requested by the Commissioner, or any collector, every corporation shall forward to him a correct statement of such gains and profits and the names and addresses of the individuals or shareholders who would be entitled to the same if divided or distributed, and of the amounts that would be payable to each.

ART. 351. **Profits of corporation taxable to stockholders.**—Where a domestic or foreign corporation permits its gains and profits to accumulate for the purpose of preventing the imposition of the surtax upon such income if distributed to its stockholders, it shall not be subject to the income tax as a corporation, but its stockholders shall be subject to tax in the same way as the stockholders of a personal service corporation, except that the war profits and excess profits tax on the corporation shall first be deducted from its net income before computing the proportionate shares of the stockholders. See section 218 of the statute and articles 328–335. In any case the Commissioner or a collector may require a corporation to furnish a statement of its gains and profits and of the names, addresses and shareholdings of the stockholders. If upon the basis of such statement or other evidence the Commissioner certifies that in his opinion its accumulation of profits is unreasonable for the purposes of the business, but only if he so certifies, the corporation and its stockholders shall make their returns accordingly.

ART. 352. **Purpose to escape surtax.**—The application of section 220 of the statute depends upon the two elements of (*a*) purpose to escape the surtax and (*b*) unreasonable accumulation of gains and profits. Prima facie evidence of (*a*) exists where a corporation has practically no business except holding stocks, securities or other property and collecting the income therefrom, or where a corporation other than a mere holding company permits its gains and profits to accumulate beyond the reasonable needs of the business. The business of a corporation is not limited to that which it has previously carried on, but in general includes any line of business which it may legitimately undertake. However, a radical change of business when a considerable surplus has been accumulated may afford evidence of a purpose to escape the surtax. When one corporation owns the stock of another corporation in the same or a related line of business and in effect operates the other corporation, the business of the latter may be considered in substance the business of the first corporation. Gains and profits of the first corporation put into the second through the purchase of stock or otherwise may therefore, if a subsidiary relationship is established, constitute employment of the income in its own business. To establish that the business of one corporation can be regarded as including the business of another it is ordinarily essential that the first corporation own substantially all of the stock of the second. Investment by a corporation of its income in stock and securities of another corporation is not without more to be regarded as employment of the income in its business.

ART. 353. **Unreasonable accumulation of profits.**—An accumulation of gains and profits is unreasonable if it is not required for the purposes of the business, considering all the circumstances of the case. No attempt can be made to enumerate all the ways in which gains and profits of a corporation may be accumulated for the reasonable needs of the business. Undistributed income is properly accumulated if invested in increased inventories or additions to plant reasonably needed by the business. It is properly accumulated if retained for working capital required by the business or in accordance with contract obligations placed to the credit of a sinking fund for the purpose of retiring bonds issued by the corporation. In the case of a banking institution the business of which is to receive and loan money, using capital, surplus and deposits for that purpose, undistributed income actually represented by loans or reasonably retained for future loans is not accumulated beyond the reasonable needs of the business. The nature of the investment of gains and profits is immaterial if they are not in fact needed in the business.

PAYMENT OF TAX AT SOURCE.

SEC. 221. (a) That all individuals, corporations and partnerships, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the United States, having the control, receipt, custody, disposal, or payment, of interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income, of any nonresident alien individual (other than income received as dividends from a corporation which is taxable under this title upon its net income) shall (except in the cases provided for in subdivision (b) and except as otherwise provided in regulations prescribed by the Commissioner under section 217) deduct and withhold from such annual or periodical gains, profits, and income a tax equal to 8 per centum thereof: *Provided*, That the

Commissioner may authorize such tax to be deducted and withheld from the interest upon any securities the owners of which are not known to the withholding agent.

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

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

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

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

ART. 361. **Withholding tax at source.**—In general withholding is required (*a*) of a tax of 8 per cent in the case of fixed or determinable annual or periodical income (other than dividends from corporations liable to the income tax and interest upon corporate bonds containing a tax-free covenant clause) payable to a nonresident alien individual; (*b*) of a tax of 10 per cent in the case of fixed or determinable annual or periodical income (other than dividends from corporations liable to the income tax and interest upon corporate bonds containing a tax-free covenant clause) payable to a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein; and (*c*) of a tax of 2 per cent in the case of interest payable to an individual or a partnership, whether resident or nonresident, or to a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein, upon bonds or other obligations of domestic or resident foreign corporations containing a so-called tax-free covenant clause. Where the owner of bonds or other securities is unknown to the withholding agent a tax of 2 per cent must be withheld from interest on so-called tax-free covenant bonds, and a tax of 8 per cent must be withheld from interest on all other bonds or securities. Bonds issued under a trust deed containing a tax-free covenant are treated as if they contained such a covenant. A foreign corporation having a fiscal agent or paying agent in this country is required to withhold a tax of 2 per cent upon the interest on its tax-free covenant bonds. See further sections 200, 217, 237, and 256 of the statute and articles 1533, 311–316, 601, and 1071–1080.

ART. 362. **Fixed or determinable annual or periodical income.**—Only (*a*) fixed or determinable (*b*) annual or periodical income is subject to withholding. Among such income, giving an idea of the general character of income intended, the statute specifies interest, rent, salaries, wages, premiums, annuities, compensations, remunerations and emoluments. But other kinds of income may be included. (*a*) Income is fixed when it is to be paid in amounts definitely predetermined. On the other hand, it is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained. (*b*) The income need not be paid annually if it is paid periodically, that is to say, from time to time, whether or not at regular intervals. That the length of time during which the payments are to be made may be increased or diminished in accordance with someone's will or with the happening of an event does not make the payments any the less determinable or periodical. A salesman working by the month for a commission on sales which is paid or credited monthly receives determinable periodical income.

ART. 363. **Exemption from withholding.**—Withholding from interest on bonds or other obligations containing a tax-free covenant shall not be required in the case of a citizen or resident alien individual if he files with the withholding agent when presenting interest coupons for payment, or not later than February first following the taxable year, an ownership certificate on form 1001 (revised) claiming a personal exemption or credit for dependents. See section 216 of the statute and articles 301–305. To avoid inconvenience a resident alien individual should file a certificate of residence on form 1078 (revised) with withholding agents, who shall forward such certificates to the Commissioner with a letter of transmittal. See article 315. Withholding is required from income of a nonresident alien individual, except as provided in article 316. No withholding from corporate dividends (other than distributions by a personal service corporation) is required in any case. The income of domestic and resident foreign corporations is free from withholding.

ART. 363(a). **Personal exemption of nonresident aliens.**—In case a nonresident alien is entitled to personal exemption and credits for dependents in accordance with paragraphs (c), (d), and (e), section 216 of the Revenue Act of 1918, and his gross income from sources in the United States, including bond interest, does not exceed his personal exemption and credits for dependents, a certificate, form 1001B, should be executed and filed with the withholding agent, if any part of the gross income is derived from interest upon bonds of a domestic corporation which contain a tax-free covenant clause. The certificate may be filed with the withholding agent at the end of the calendar year, but not later than February 1 of the succeeding year, and all such certificates should be attached to the annual list return, form 1013. The amount of tax due from the withholding agent, as shown by form 1013, may be reduced by 2 per cent of the aggregate amount of interest payments made to the nonresident alien upon tax-free covenant bonds during the calendar year, and the amount of tax represented by the certificates, payment of which was assumed on monthly list return, form 1012, will not be included in the assessment against the withholding agent. The certificate may be filed only by a citizen or subject of the countries enumerated in paragraph (a) or (b) of article 307, as amended. In case tax in excess of a nonresident alien's tax liability has been withheld from interest upon bonds which do not contain a tax-free covenant clause, the nonresident alien should file or cause to be filed with the collector of internal revenue a return of his gross income from all sources within the United States, accompanied by a claim for refund on form 46.

ART. 364. **Ownership certificates for interest coupons.**—The owners of bonds or other obligations, whether or not containing a tax-free covenant, issued by domestic or resident foreign corporations, when presenting interest coupons for payment shall file a certificate of ownership for each issue of bonds, showing the name and address of the debtor corporation, the name and address of the owner of the bonds, the nature of the obligations, the amount of interest and its due date, and the amount of any tax withheld. No ownership certificates need be filed in the case of interest payments on bonds the income from which is not required to be included in gross income, nor in the case of any obligations of the United States. See section 213 (b) of the statute and articles 74–82. Where in connection with the sale of its property payment of the bonds or other obligations of a corporation is assumed by the assignee, such assignee, whether an individual, partnership, corporation, or a State or political subdivision thereof, must deduct and withhold such taxes as would have been required to be withheld by the assignor had no such sale and transfer been made. As to ownership certificates in the case of bonds of foreign countries, or bonds or stocks of nonresident foreign corporations, see article 1078.

ART. 365. **Form of certificate where withholding required.**—For the purposes of article 364, form 1000 (revised) shall be used (*a*) by citizens or residents of the United States when no personal exemption or credit is claimed against interest on bonds containing a tax-free covenant; (*b*) by nonresident alien individuals, and by foreign corporations not engaged in trade or business within the United States and not having any office or place of business therein, whether or not such bonds contain a tax-free covenant; (*c*) by partnerships, resident or nonresident, and personal service corporations, in the case of bonds containing a tax-free covenant; and (*d*) where the owner is unknown to the withholding agent.

ART. 366. **Form of certificate where no withholding required.**—For the purposes of article 364, form 1001 (revised) shall be used (*a*) by citizens or residents of the United States when personal exemption is claimed against interest on bonds containing a tax-free covenant and when presenting coupons from bonds not containing a tax-free covenant; (*b*) by domestic corporations; (*c*) by partnerships, resident or nonresident, in the case of bonds not containing a tax-free covenant; (*d*) by foreign corporations engaged in trade or business within the United States or having an office or place of business therein, whether or not such bonds contain a tax-free covenant; and (*e*) by foreign governments, whether or not the bonds contain a tax-free covenant. In case a citizen or resident alien individual receives interest on bonds containing a tax-free covenant in excess of the amount of personal exemption which the individual may claim, any such excess must be reported on form 1000 (revised).

ART. 367. **Use of substitute certificates.**—Resident collecting agents, including responsible banks and bankers receiving interest coupons for collection with ownership certificates attached may present the coupons with the original certificates to the debtor corporation or its duly authorized withholding agent for collection or may detach and forward the original certificates directly to the Commissioner, provided each such collecting agent shall substitute for such original certificates its own certificates (form 1058 [revised] or form 1059 [revised]) and shall keep a complete record of each transaction, showing (*a*) serial number of item received; (*b*) date received; (*c*) name and address of person from whom received; (*d*) name of debtor corporation; (*e*) class of bonds from which coupons were cut (whether containing a tax-free covenant or not); and (*f*) face amount of coupons. The original certificate for which the certificate of the collecting agent is substituted shall be indorsed, preferably with a rubber stamp, by the collecting agent, as follows:

Owner's certificate No. ________

____
(Name of collecting agent.)

______________________________, 19__
(Give date of certificate.)

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

For the purpose of identification the substitute certificates shall be numbered consecutively, reverting to the numeral 1 at the beginning of each calendar year, and corresponding numbers given the original certificates of ownership. The use of substitute certificates by collecting agents, banks, and bankers is not permitted, however, in the case of ownership certificates presented with coupons for collection by nonresident alien individuals, partnerships, or corporations.

ART. 368. **Interest coupons without ownership certificates.**—When interest coupons are received unaccompanied by certificates of ownership, the first bank shall require of the payee an affidavit showing the name and address of the payee, the name and address of the debtor corporation, the date of the maturity of the interest, the name and address of the person from whom the coupons were received, the amount of the interest, and a statement that the owner of the bonds is unknown to the payee. Such affidavit shall be forwarded to the collector with the monthly return on form 1012 (revised). The first bank receiving such coupons shall also prepare a certificate on form 1000 (revised), crossing out "owner" and inserting "payee" and entering the amount of interest on line 6, and shall stamp or write across the face of the certificate "Affidavit furnished," adding the name of the bank.

ART. 369. **Interest on registered bonds.**—Where a bondholder files no ownership certificate in the case of payments of interest on registered bonds the withholding agent shall make out such a certificate in each instance (*a*) on form 1000 (revised) if the bondholder is a citizen or resident of the United States or a resident or nonresident partnership, or a personal service corporation, and the bonds contain a tax-free covenant, or if the bondholder is a nonresident alien individual, or a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein, and (*b*) on form 1001 (revised) in all other cases. When so used forms 1000 (revised) and 1001 (revised) need not be signed.

ART. 370. **Return of tax withheld.**—(*a*) Every withholding agent shall make an annual return to the collector of the tax withheld from interest on corporate bonds or other obligations on or before March 1 on form 1013 (revised). He shall also make a monthly return on form 1012 (revised) on or before the 20th day of the month following that for which the return is made. The original ownership certificates, or the substitute certificates where authorized, must be forwarded to the collector with the monthly return. (*b*) Every person required to deduct and withhold any tax from income other than such bond interest shall make an annual return thereof to the collector on or before March 1 on form 1042 (revised), accompanied by a separate report on form 1098 (revised) for each nonresident alien individual, or foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein, to whom income other than bond interest was paid during the previous taxable year. In every case of both classes the tax withheld must be paid on or before June 15 of each year to the collector. For penalties attaching upon failure to make such returns or such payment, see section 253 of the statute, section 3176 of the Revised Statutes as amended, and articles 1004, 1005, and 1041.

ART. 371. **Withholding in 1918.**—In the case of payments made prior to February 25, 1919, where a withholding agent pursuant to the Revenue Acts of 1916 and 1917 withheld only 2 per cent from the income of nonresident alien individuals, he need return only such sum. In all such cases where a withholding agent withheld the tax pursuant to the Revenue Acts of 1916 and 1917 from the income of foreign corporations not engaged in trade or business within the United States and not having any office or place of business therein, he need return only the sum withheld, to an amount not in excess of the aggregate sum required to be withheld by the terms of the Revenue Act of 1918 from the income paid over by the withholding agent. In the case of every payment made after February 24, 1919, the withholding agent must withhold at the rates prescribed by the present statute from the whole payment, not merely from that part which applies to the period after February 24, 1919.

ART. 372. **Release of excess tax withheld.**—Any sum withheld for tax since December 31, 1917, in excess of the aggregate amount required under the terms of the Revenue Act of 1918, shall be released by the withholding agent and paid over to the person from whom it was withheld or his proper representative. With reference to how a debtor corporation may release and pay over the amount of tax so withheld in a case where a bank or other collection agency detached the ownership certificate which accompanied an interest coupon and substituted its own certificate (form 1059), which does not disclose the name and address of the bond owner, in such cases the withholding agent shall request the bank or collection agency to disclose the name and address of the owner of the bonds, as shown by the original certificate, and it shall be the duty of the bank or collection agency to make such disclosure to the withholding agent. Where withholding agents have so released any excess of tax, an itemized statement showing the names, addresses, and amounts refunded should be attached to the annual list return (form 1013), in order to reconcile any discrepancy between the aggregate amount of taxes returned as shown by the monthly list returns (form 1012) and the aggregate amount as shown by the annual list return.

ART. 373. **Use of information return where no actual withholding.**—Where a debtor corporation or its duly authorized withholding agent has made payments of interest on its bonds, but in certain instances has been required to withhold no tax, the ownership certificates on form 1001 (revised) filed in connection with such payments shall be transmitted directly to the Commissioner, accompanied by a return on form 1096–A showing the number of ownership certificates thus transmitted and the total amount of interest paid. This return shall be made by the 20th day of each month following that for which the return is made and need not be sworn to. An annual return shall be forwarded to the Commissioner not later than March 15 of each year on form 1096–B, on which shall be given a summary of the monthly returns. To the extent that there has been actual withholding of the tax returns should be made in accordance with article 370.

ART. 374. **Ownership certificates in the case of fiduciaries and joint owners.**—When fiduciaries have the control and custody of more than one estate or trust, and such estates and trusts have as assets bonds of corporations and other securities, a certificate of ownership shall be executed for each estate or trust, regardless of the fact that the bonds are of the same issue. When bonds are owned jointly by several persons, a separate ownership certificate must be executed in behalf of each of the owners.

ART. 375. **Withholding in the case of enemies.**—Payments made after October 6, 1917, to the Alien Property Custodian are in the same category as payments made to or for citizens or residents of the United States. Withholding at the source is accordingly unnecessary except in the case of interest payments on corporate bonds or other obligations containing a tax-free covenant where no exemption is claimed. The Alien Property Custodian should use form 1000 (revised) in collecting interest on bonds containing a tax-free covenant and in all other cases should use form 1001 (revised), except that in cases in which the Alien Property Custodian shall, under the Trading with the Enemy Act, demand payment to himself of interest accrued upon bonds or other securities not yet reduced to his custody (even though they be registered in the name of an enemy, ally of enemy, or his agent or trustee), the corporation paying such income to the Alien Property Custodian is authorized to accept from the Alien Property Custodian ownership certificates, forms 1000 (revised) and 1001 (revised), altered by the substitution (in lieu of the certificate required thereon) of a certificate that the Alien Property Custodian is entitled to the interest entered therein with or without deduction of tax, as the case may be. No distinction is to be made between payments directly to the Alien Property Custodian and to his depositaries and between interest on registered bonds and interest on coupon bonds. In the case of enemies or allies of enemies holding a license granted under the provisions of the Trading with the Enemy Act, withholding is required as in the case of any nonresident alien not an enemy or ally of enemy. See article 446.

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

CREDIT FOR TAXES.

SEC. 222. (a) That the tax computed under Part II of this title shall be credited with:

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

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

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

(4) In the case of any such individual who is a member of a partnership or a beneficiary of an estate or trust, his proportionate share of

such taxes of the partnership or the estate or trust paid during the taxable year to a foreign country or to any possession of the United States, as the case may be.

(b) If accrued taxes when paid differ from the amounts claimed as credits by the taxpayer, or if any tax paid is refunded in whole or in part, the taxpayer shall notify the Commissioner who shall redetermine the amount of the tax due under Part II of this title for the year or years affected, and the amount of tax due upon such redetermination, if any, shall be paid by the taxpayer upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 252. In the case of such a tax accrued but not paid, the Commissioner as a condition precedent to the allowance of this credit may require the taxpayer to give a bond with sureties satisfactory to and to be approved by the Commissioner in such penal sum as the Commissioner may require, conditioned for the payment by the taxpayer of any amount of tax found due upon any such redetermination; and the bond herein prescribed shall contain such further conditions as the Commissioner may require.

(c) These credits shall be allowed only if the taxpayer furnishes evidence satisfactory to the Commissioner showing the amount of income derived from sources within such foreign country or such possession of the United States, and all other information necessary for the computation of such credits.

Art. 381. **Analysis of credit for taxes.**—(1) In the case of a citizen of the United States, whether resident on nonresident, the basis of the credit for taxes is as follows: (*a*) "the amount of any income, war-profits and excess-profits taxes paid" or accrued "during the taxable year * * * to any possession of the United States"; (*b*) "the amount of any" such taxes paid or accrued "during the taxable year to any foreign country, upon income derived from sources therein"; and (*c*) the "proportionate share of" any "such taxes of" a partnership of which he is a partner or of an estate or trust of which he is a beneficiary paid or accrued "during the taxable year to a foreign country or to any possession of the United States, as the case may be."

(2) In the case of an alien resident of the United States the basis of the credit for taxes is as follows: (*a*) "the amount of any income, war-profits and excess-profits taxes paid" or accrued "during the taxable year * * * to any possession of the United States" (identical with (1) (*a*) above); (*b*) "the amount of any such taxes paid" or accrued "during the taxable year to" the country of which he is a citizen or subject, "upon income derived from sources therein, if such country, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country"; and (*c*) the "proportionate share of" any "such taxes of" a partnership of which he is a partner or of an estate or trust of which he is a beneficiary paid or accrued "during the taxable year to" the country of

which he is a citizen or subject ("if such country, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country"), "or to any possession of the United States, as the case may be." As to credits for taxes in the case of corporations see section 238 of the statute and article 611.

ART. 382. **Meaning of terms.**—"Amount of * * * taxes paid during the taxable year" means taxes proper (no credit being given for amounts representing interest or penalties) paid or accrued during the taxable year on behalf of the individual claiming credit. "Foreign country" includes within its meaning any foreign sovereign state or self-governing colony (for example, the Dominion of Canada), but does not include a foreign municipality (for example, Montreal) unless itself a sovereign State (for example, Hamburg). "Any possession of the United States" includes, among others, Porto Rico, the Philippines, and the Virgin Islands. As to the meaning of "sources" see articles 91–93. See also section 1 of the statute.

ART. 383. **Conditions of allowance of credit.**—(*a*) When credit is sought for income, war profits or excess profits taxes paid other than to the United States, the income tax return of the individual must be accompanied by form 1116, carefully filled out with all the information there called for and with the calculations of credits there indicated, and duly signed and sworn to or affirmed. When credit is sought for taxes already paid the form must have attached to it the receipt for each such tax payment. When credit is sought for taxes accrued the form must have attached to it the return on which each such accrued tax was based. This receipt or return so attached must be either the original, a duplicate original, a duly certified or authenticated copy, or a sworn copy. In case only a sworn copy of a receipt or return is attached, there must be kept readily available for comparison on request the original, a duplicate original or a duly certified or authenticated copy. (*b*) In the case of a credit sought for a tax accrued but not paid, the Commissioner may require as a condition precedent to the allowance of credit a bond from the taxpayer in addition to form 1116. If such a bond is required, form 1117 shall be used for it. It shall be in such penal sum as the Commissioner may prescribe, and shall be conditioned for the payment by the taxpayer of any amount of tax found due upon any redetermination of the tax made necessary by such credit proving incorrect, with such further conditions as the Commissioner may require. This bond shall be executed by the taxpayer, his agent or representative, as principal, and by sureties satisfactory to and approved by the Commissioner. See also section 1320 of the statute.

ART. 384. **Redetermination of tax when credit proves incorrect.**—In case credit has been given for taxes accrued, or a proportionate share thereof, and the amount that is actually paid on account of such taxes, or a proportionate share thereof, is not the same as the amount of such credit, or in case any tax payment credited is refunded in whole or in part, the taxpayer shall immediately notify the Commissioner. The Commissioner will thereupon redetermine the amount of the income tax of such taxpayer for the year or years for which such incorrect credit was granted. The amount of tax, if any, due upon such redetermination shall be paid by the taxpayer upon notice and demand by the collector. The amount of tax, if any, shown by such redetermination to have been overpaid shall be credited against any income, war profits or excess profits taxes, or installment thereof, then due from such taxpayer under any other return, and any balance of such amount shall be immediately refunded to him. See section 252 of the statute and articles 1031–1038.

ART. 385. **Countries which do or do not satisfy the similar credit requirement.**—(*a*) The following is an incomplete list of the countries which satisfy the similar credit requirement of section 222 (*a*) (3) of the Revenue Act of 1918, either by allowing to citizens of the United States residing in such countries a credit for the amount of income, war profits, or excess profits taxes paid to the United States upon incomes derived from sources therein, or in imposing such taxes, by exempting from taxation the incomes received from sources within the United States by citizens of the United States residing in such countries: Bulgaria, Canada, Italy, Newfoundland, Salvador. (*b*) The following is an incomplete list of the countries which do not satisfy the similar credit requirement of section 222 (*a*) (3) of the Revenue Act of 1918, either by allowing no credit to citizens of the United States residing in such countries, for the amount of income, war profits, or excess profits taxes paid to the United States upon incomes derived from sources therein, or because such countries do not impose any income, war profits, or excess profits taxes: Argentina, Bahama, Belgium, Bermuda, Bolivia, Bosnia, Brazil, Chile, China, Costa Rica, Ecuador, Egypt, Finland, France, Great Britain and Ireland, Guatemala, Herzegovina, India, Jamaica, Japan, Montenegro, Morocco, New Zealand, Nicaragua, Panama, Paraguay, Persia, Peru, Portugal, Roumania, Santo Domingo, Serbia, Siam, Sweden, Switzerland, Venezuela. The former names of certain of these territories are here used for convenience in spite of the actual or possible change in the name or sovereignty. A resident of the United States who is a citizen or subject of any country in the first list is entitled, for the purpose of the total tax due the United States for 1918 and subsequent years, to a credit for the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to such country upon income from sources therein. If he is a citizen or subject of any country in the second list, he is not entitled to such credit. If he is a citizen or subject of a country which is in neither list, then to secure the desired credit he must prove to the satisfaction of the Commissioner that his country satisfies the similar credit requirement of the statute.

INDIVIDUAL RETURNS.

SEC. 223. That every individual having a net income for the taxable year of $1,000 or over if single or if married and not living with husband or wife, or of $2,000 or over if married and living with husband or wife, shall make under oath a return stating specifically the items of his gross income and the deductions and credits allowed by this title. If a husband and wife living together have an aggregate net income of $2.000 or over, each shall make such a return unless the income of each is included in a single joint return.

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

ART. 401. **Individual returns.**—Every individual whose net income, as defined in section 212 of the statute and articles 21–26, is $1,000 or over for the taxable year must make a return of income unless married and living with husband or wife as defined in article 303. The return shall be for his taxable year, whether calendar or fiscal. Whether or not an individual is the head of a family or has dependents is immaterial in determining his liability to render a return. If an individual is a married person living with husband or wife, no return need be made where their aggregate net income is less than $2,000; but a separate return must be made by each of them, regardless of the amount of the individual income of each, where their aggregate net income is $2,000 or over, unless they join in a single return. The husband shall include in his return the income derived from services rendered by the wife or from the sale of products of her labor if she does not file a separate return or join with him in a return setting forth her income separately. For returns by partnerships see section 224 and articles 411 and 412; by fiduciaries see section 225 and articles 421–425; by personal service corporations see section 239 and article 624; and by other corporations see sections 239 and 240 and articles 621–626 and 631–638. See also section 227 and articles 441–448.

ART. 402. **Form of return.**—The return shall be on form 1040 (revised), except that it may be on short form 1040 A (revised) where the net income does not exceed $5,000 and the net income subject to the normal tax, that is, after applying the personal exemption and other credits, does not exceed $4,000. The forms are provided by the Commissioner and may be had from the collectors of the several districts. In the case of a person owning State, municipal, United States, farm loan, or War Finance Corporation bonds, his return shall contain a statement showing the number and amount of such obligations owned by him, the income received therefrom, and the other information called for in the form. See section 213 (b) (4) of the statute. The return may be made by an agent when by reason of illness, absence or nonresidence the person liable for the return is unable to make it, the agent assuming the responsibility for making the return and incurring liability to the specific penalties provided for erroneous, false or fraudulent returns. See section 253 and article 1041.

ART. 403. **Return of income of minor.**—An individual under 21 years of age or under the statutory age of majority where he lives, whatever it may be, is required to render a return of income if he has a net income of his own of $1,000 or over for the taxable year. If he is married see article 401. If a minor has been emancipated by his parent his earnings are his own income and such earnings, regardless of amount, are not required to be included in the return of the parent. If the aggregate of the net income of a minor from any property which he possesses, and from any funds held in trust for him by a trustee or guardian, and from his earnings in case he has been emancipated, is at least $1,000, a return as in the case of any other individual must be made by him or by his guardian, or some other person charged with the care of his person or property for him. See article 422. If, however, a minor has not been emancipated by his parent, who appropriates or may appropriate his earnings, such earnings, regardless of amount, are income of the parent and not of the minor for the purpose of the normal tax and surtax. In the absence of proof to the contrary, a parent will be assumed not to have emancipated his minor child and must include in his return any earnings of the minor.

ART. 404. **Return of income of nonresident alien.**—A nonresident alien individual shall make or have made a full and accurate return on form 1040 (revised) or form 1040 A (revised) of his income received from sources within the United States, regardless of amount, unless the tax on such income has been fully paid at the source. See section 217 of the statute and articles 311–316. The responsible representatives of nonresident aliens in connection with any sources of income which such nonresident aliens may have within the United States shall make a return of such income, and shall pay any and all tax, normal and additional, assessed upon the income received by them in behalf of their nonresident alien principals, in all cases where the tax on income so in their receipt, custody, or control shall not have been withheld at the source. The agent of a nonresident alien is responsible for a correct return of all income accruing to his principal within the purview of the agency. The agency appointment will determine how completely the agent is substituted for the principal for tax purposes. Where upon filing a return of income it appears that a nonresident alien is not liable for tax, but nevertheless a tax shall have been withheld at the source, in order to obtain a refund on the basis of the showing made by the return there should be attached to it a statement showing accurately the amounts of tax withheld, with the names and post-office addresses of all withholding agents. See article 376.

ART. 405. **Return of corporate dividends.**—Dividends on stock of domestic corporations or resident foreign corporations are prima facie income of the record owner of the stock, and such record owner will be liable for any additional tax based thereon, unless a disclosure of the actual ownership is made to the Commissioner on form 1087 (revised) which shall show that the record owner is not the actual owner and who the owner is and his address. In all cases where the actual owner is a nonresident alien individual and the record owner is a person in the United States, the record owner will be considered for tax purposes to have the receipt, custody, control, and disposal of the dividend income and will be required to make return for the actual owner, regardless of the amount of the income, and to pay any surtax found by such return to be due.

ART. 406. **Verification of returns.**—All income tax returns must be verified under oath or affirmation, before an officer duly authorized to administer oaths either by the laws of the United States or by the laws of the State or Territory where such officer resides. Persons in the naval or military service of the United States may verify their returns before any official authorized to administer oaths for the purposes of those services. Income tax returns executed abroad may be attested free of charge before United States consular officers. Where a foreign notary or other official having no seal shall act as attesting officer, the authority of such attesting officer should be certified to by some judicial official or other proper officer having knowledge of the appointment and official character of the attesting officer.

ART. 407. **Use of prescribed forms.**—Copies of the prescribed return forms will so far as possible be furnished taxpayers by collectors. Failure on the part of any taxpayer to receive a blank form will not, however, excuse him from making a return. Taxpayers not supplied with the proper forms should make application therefor to the collector in ample time to have their returns prepared, verified, and filed with the collector on or before the last due date. Each taxpayer should carefully prepare his return so as fully and clearly to set forth the data therein called for. Imperfect or incorrect returns will not be accepted as meeting the requirements of the statute. In lack of a prescribed form a statement made by a taxpayer disclosing his gross income and the deductions therefrom may be accepted as a tentative return, and if filed within the prescribed time a return so made will relieve the taxpayer from liability to penalties, provided that without unnecessary delay such a tentative return is replaced by a return made on the proper form. See further articles 443–446.

PARTNERSHIP RETURNS.

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

ART. 411. **Partnership returns.**—Every partnership must make a return of income, regardless of the amount of its net income. The return shall be on form 1065 (revised) and shall be sworn to by one of the partners. Such return shall be made for the taxable year of the partnership, that is, for its annual accounting period (fiscal year or calendar year as the case may be), irrespective of the taxable years of the partners. See section 218 of the statute and articles 321–327. If the partnership makes any change in its accounting period, it shall make its return in accordance with the provisions of section 226 and article 431. See also article 424.

ART. 412. **Contents of partnership return.**—The return of a partnership shall state specifically (*a*) the items of its gross income enumerated in section 213 of the statute; (*b*) the deductions enumerated in section 214, other than the deduction provided in paragraph (11) of subdivision (a) of that section; (*c*) the amounts specified in subdivisions (a) and (b) of section 216 received by the partnership; (*d*) the amount of any income, war profits and excess profits taxes of the partnership paid during the taxable year to a foreign country or to any possession of the United States, and the amount of any such taxes accrued but not paid during the taxable year; (*e*) the names and addresses of the individuals who would be entitled to share in the net income of the partnership if distributed; (*f*) the amount of the distributive share of such net income of each such individual; and (*g*) such other facts as are required by form 1065 (revised). See also sections 222 and 227 and articles 381–385 and 441–448.

FIDUCIARY RETURNS.

SEC. 225. That every fiduciary (except receivers appointed by authority of law in possession of part only of the property of an individual) shall make under oath a return for the individual, estate or trust for which he acts (1) if the net income of such individual is $1,000 or over if single or if married and not living with husband or wife, or $2,000 or over if married and living with husband or wife, or (2) if the net income of such estate or trust is $1,000 or over or if any beneficiary of such estate or trust is a nonresident alien, stating specifically the items of the gross income and the deductions and credits allowed by this title. Under such regulations as the Commissioner with the approval of the Secretary may prescribe, a return made by one of two or more joint fiduciaries and filed in the office of the collector of the district where such fiduciary resides shall be a sufficient compliance with the above requirement. The fiduciary shall make oath that he has sufficient knowledge of the affairs of such individual, estate or trust to enable him to make the return, and that the same is, to the best of his knowledge and belief, true and correct.

Fiduciaries required to make returns under this act shall be subject to all the provisions of this act which apply to individuals.

ART. 421. **Fiduciary returns.**—Every fiduciary, or at least one of joint fiduciaries, must make a return of income (*a*) for the individual whose income is in his charge, if the net income of such individual is $2,000 or over if married and living with husband or wife or is $1,000 or over in other cases, or (*b*) for the estate or trust for which he acts, if the net income of such estate or trust is $1,000 or over or if any beneficiary of such estate or trust is a nonresident alien. The return in case (*a*) and also in case (*b*) if the tax is payable by the fiduciary shall be on form 1040 (revised), except that it may be on short form 1040 A (revised) where the net income does not exceed $5,000. The return shall be on form 1041 (revised) in case (*b*) if the tax is payable by the beneficiaries. In such a case the fiduciary shall include in the return a statement of each beneficiary's distributive share of the net income, whether or not distributed before the close of the taxable year for which the return is made. See section 219 of the statute and articles 341–347. If the net income of a decedent from the beginning of the taxable year to the date of his death was $1,000 or more, if unmarried, or $2,000 or more, if married, the executor or administrator shall make a return for such decedent. See article 305.

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

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

ART. 424. **Return by receiver.**—A receiver who stands in the stead of an individual or corporation must render a return of income and pay the tax for his trust, but a receiver of only part of the property of an individual or corporation need not. If the receiver acts for an individual the return shall be on form 1040 (revised) or 1040 A (revised). When acting for a corporation a receiver is not treated as a fiduciary, and in such a case the return shall be made as if by the corporation itself. See section 239 of the statute and article 622. A receiver in charge of the business of a partnership shall render a return on form 1065 (revised). A receiver of the rents and profits appointed to hold and operate a mortgaged parcel of real estate, but not in control of all the property or business of the mortgagor, and a receiver in partition proceedings, are not required to render returns of income. In general, statutory receivers and common law receivers of all the property or business of an individual or corporation must make returns. See also section 256 of the statute and articles 1071–1080.

ART. 425. **Return for nonresident alien beneficiary.**—Where a citizen or resident fiduciary has the distribution of trust income for which there is a nonresident alien beneficiary, the fiduciary must make a return on form 1040 (revised) or 1040 A (revised) for such nonresident alien and pay the tax. If there are two or more beneficiaries, the fiduciary shall render a return on form 1041 (revised) and also a return on form 1040 (revised) or 1040 A (revised) for each nonresident alien beneficiary.

RETURNS WHEN ACCOUNTING PERIOD CHANGED.

SEC. 226. That if a taxpayer, with the approval of the Commissioner, changes the basis of computing net income from fiscal year to calendar year a separate return shall be made for the period between the close of the last fiscal year for which return was made and the following December 31. If the change is from calendar year to fiscal year, a separate return shall be made for the period between the close of the last calendar year for which return was made and the date designated as the close of the fiscal year. If the change is from one fiscal year to another fiscal year a separate return shall be made for the period between the close of the former fiscal year and the date designated as the close of the new fiscal year. If a taxpayer making his first return for income tax keeps his accounts on the basis of a fiscal year he shall make a separate return for the period between the beginning of the calendar year in which such fiscal year ends and the end of such fiscal year.

In all of the above cases the net income shall be computed on the basis of such period for which separate return is made, and the tax shall be paid thereon at the rate for the calendar year in which such period is included; and the credits provided in subdivisions (c) and

(d) of section 216 shall be reduced respectively to amounts which bear the same ratio to the full credits provided in such subdivisions as the number of months in such period bears to twelve months.

ART. 431. **Returns when accounting period changed.**—No return can be made for a period of more than twelve months. A separate return for a fractional part of a year is, therefore, required wherever there is a change, with the approval of the Commissioner, in the basis of computing net income from one taxable year to another taxable year or wherever a taxpayer making his first return of income does so on the basis of a fiscal year. The periods to be covered by such separate returns in the several cases are stated in the statute. The requirements with respect to the filing of a separate return and the payment of tax for a part of a year are the same as for the filing of a return and the payment of tax for a full taxable year closing at the same time. See sections 227 and 250 of the statute and articles 441–448 and 1001. The tax on net income computed on the basis of the period for which a separate return is made shall be paid thereon at the rate for the calendar year in which such period is included, and the credits for personal exemption and dependents shall be such proportion of the full credits as the number of months in such period bears to twelve months. See section 216 and article 305. See further section 212 and articles 25 and 26, and as to corporations sections 232 and 239 and articles 531 and 626.

TIME AND PLACE FOR FILING RETURN.

SEC. 227. (a) That returns shall be made on or before the fifteenth day of the third month following the close of the fiscal year, or, if the return is made on the basis of the calendar year, then the return shall be made on or before the fifteenth day of March. The Commissioner may grant a reasonable extension of time for filing returns whenever in his judgment good cause exists and shall keep a record of every such extension and the reason therefor. Except in the case of taxpayers who are abroad, no such extension shall be for more than six months.

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

ART. 441. **Time for filing return.**—Returns of income must be made on or before the fifteenth day of March following the taxable year, except that returns on the basis of a fiscal year other than the calendar year must be made on or before the fifteenth day of the third month following the close of the fiscal year. Returns on the basis of fiscal years ending in 1918 of taxpayers who made returns on the calendar year basis for the year 1917 shall be made on or before the fifteenth day of March, 1919. See also sections 250 and 253 of the statute and articles 1001–1013 and 1041.

ART. 442. **Time for filing return upon death or termination of trust.**—As soon as possible after his appointment and qualification, without waiting for the close of the taxable year, an executor or administrator shall file a return of income for the decedent. Upon the completion of the administration of an estate and final accounting an executor or administrator shall file a return of income of the estate for the portion of the taxable year in which the administration was closed, attaching to the return a certified copy of the order for his discharge. An ancillary administrator need make no separate return if the domiciliary administrator includes in his return the entire income of the estate. Similarly, upon the termination of any other trust the trustee shall make a return without waiting for the close of the taxable year. In any such case the requirements with respect to the payment of the tax are the same as if the return were for a full taxable year closing at the end of the month during which the decedent dies or the estate is settled or the trust is terminated, as the case may be. The payment of the tax before the end of the taxable year in such circumstances does not relieve the taxpayer from liability for any additional tax which might subsequently be imposed upon income of the taxable year.

ART. 443. **Extension of time by collector.**—It is important that the taxpayer render before the return due date a return as complete and final as it is possible for him to prepare. However, in cases of sickness or absence collectors are authorized to grant an extension of not exceeding 30 days, where in their judgment such further time is actually required for the making of an accurate return. See article 1002. The application for such extension must be made prior to the expiration of the period for which the extension is desired. The absence or sickness of one or more officers of a corporation at the time the return is required to be filed will not be accepted as a reasonable cause for failure to file the return within the prescribed time, unless it is satisfactorily shown that there were no other principal officers available and sufficiently informed as to the affairs of the corporation to make and verify the return. As a condition of granting an extension of time for filing a return the collector may require the submission of a tentative return and estimate of the tax on form 1040–T in the case of individuals, or on form 1031–T in the case of corporations, and the payment of one-fourth of the estimated amount of tax. Where a taxpayer has filed a tentative return and has failed to file a complete return within the period of the extension requested by him, the complete return when filed is subject to penalties prescribed for delinquency. Where a tentative return has been filed and no time has been fixed within which a complete return must be filed, the collector may at any time send notice to the taxpayer to file a complete return within a period of time therein specified by him, and a taxpayer who fails to comply with such request will incur the penalties prescribed by statute for delinquency in filing a return.

ART. 444. **Extension of time by Commissioner.**—If before the end of an extension of thirty days granted by the collector an accurate return can not be made, an appeal for a further extension must be made to the Commissioner with a full recital of the causes for the delay. The Commissioner will not grant an additional extension without a clear showing that a complete return can not be made at the end of the thirty-day period. The Commissioner will grant no such extension beyond the original due date of the third installment of the tax. Either a complete or a tentative return, as complete as possible and giving a ground for assessment of the tax, must be submitted on or before the due date as extended, and the tax shown to be due must be paid with the submission of the return. If a complete return can not be made at that time, the facts must be submitted to the Commissioner for such further action as he deems warranted. In exceptional circumstances the taxpayer may apply originally to the Commissioner for an extension of time.

ART. 445. **Extension of time in the case of persons abroad.**—In view of the disturbed conditions abroad and the consequent interference with the usual channels of communication, an extension of time for filing returns of income for 1918 and subsequent years and for paying the tax is hereby granted in the case of nonresident alien individuals and nonresident foreign corporations, or their proper representatives in the United States, and of American citizens residing or traveling abroad, including persons in military or naval service on duty outside the United States, for such period as may be necessary, not exceeding ninety days after proclamation by the President of the end of the war with Germany. The installments of tax which are actually due must be paid at the time of filing the return and the other installments shall be paid as they fall due. In all such cases an affidavit must be attached to the return, stating the causes of the delay in filing it, in order that the Commissioner may determine that the failure to file the return in time was due to a reasonable cause and not to willful neglect and that the return was filed without any unnecessary delay. If the showing justifies the conclusion that the failure to file the return in time was excusable, no penalty will be imposed. This extension is granted as a matter of general expediency to all persons abroad owing income, war profits and excess profits taxes to the Federal Government and is not granted upon the request of any particular taxpayer. Accordingly, in the case of taxpayers who take advantage of this general extension of time for the filing of returns and the payment of tax no interest will be collected from such taxpayers, but where a request is made by a taxpayer and an extension is granted for other reasons by the Commissioner interest will be collected at the rate of one-half of one per cent per month from the time the tax would have been due if no extension had been granted.

ART. 446. **Extension of time in the case of enemies.**—An extension of time is hereby granted for such period as may be necessary, not exceeding ninety days after proclamation by the President of the end of the war with Germany, for filing returns of income for 1918 and subsequent years and for paying the tax by or for nonresident enemies or allies of enemies, as defined by section 2 of the Trading with the Enemy Act of October 6, 1917, not holding licenses granted under the provisions of that act. The whole tax shown to be due must be paid at the time of filing the return. This extension, however, does not authorize any delay in filing returns of information. This extension is also subject to the condition that all persons who on October 6, 1917, had or since have had or may hereafter have control of any money or other property for any such enemy or ally of enemy, or who on October 6, 1917, were or since have been or may hereafter be indebted to any such enemy or ally of enemy, shall hold and deliver all said money and property in all respects subject to the Trading with the Enemy Act and to the orders of the President and of the Alien Property Custodian thereunder, and shall in due course file returns of income in respect of all such money and property for such period as may elapse or have elapsed prior to the actual delivery of such money and property to the Alien Property Custodian. As to withholding at the source see article 375.

ART. 447. **Last due date.**—The last due date is the last day upon which a return is required to be filed in accordance with the provisions of the statute or the last day of the period covered by an extension of time granted by the collector or Commissioner. When the last due date falls on Sunday or a legal holiday, the last due date for filing returns will be the day following such Sunday or legal holiday. If placed in the mails the return should be posted in ample time to reach the collector's office, under ordinary handling of the mails, on or before the date on which the return is required to be filed. If a return is made and placed in the mails in due course, properly addressed and postage paid, in ample time to reach the office of the collector on or before the last due date, no penalty will attach should the return not be actually received by such officer until subsequently to that date. Where a question may be raised as to whether or not the return was posted in ample time to reach the collector's office on or before the due date, the envelope in which the return was transmitted will be preserved by the collector and forwarded to the Commissioner with the return.

ART. 448. **Place for filing return.**—Returns of income must be delivered or mailed to the collector for the district of the legal residence or principal place of business of the person making the return.

Persons having no domicile or place of business in the United States, and persons in the military or naval service of the United States, may file their returns of income with the collector at Baltimore.

UNDERSTATEMENT IN RETURNS.

SEC. 228. That if the collector or deputy collector has reason to believe that the amount of any income returned is understated, he shall give due notice to the taxpayer making the return to show cause why the amount of the return should not be increased, and upon proof of the amount understated, may increase the same accordingly. Such taxpayer may furnish sworn testimony to prove any relevant facts and if dissatisfied with the decision of the collector may appeal to the Commissioner for his decision, under such rules of procedure as may be prescribed by the Commissioner with the approval of the Secretary.

ART. 451. **Understatement of income.**—If a collector suspects that the amount of any income is understated in a return, he may on his own initiative take up the matter with the taxpayer and upon becoming satisfied that the amount was understated may increase it accordingly, subject to the right of the taxpayer to appeal to the Commissioner. The Commissioner, however, without the intervention of the collector may exercise original jurisdiction in cases of understatements or other errors in returns, in which event sections 250 and 1305 of the statute and section 3176 of the Revised Statutes, as amended by section 1317 of the statute, are applicable instead of section 228. See articles 1002, 1005, and 1711. Section 3172 of the Revised Statutes, as amended by section 1317 of the Revenue Act of 1918, provides:

SEC. 3172. Every collector shall, from time to time, cause his deputies to proceed through every part of his district and inquire after and concerning all persons therein who are liable to pay any internal-revenue tax, and all persons owning or having the care and management of any objects liable to pay any tax, and to make a list of such persons and enumerate said objects.

See also section 3173 of the Revised Statutes as amended by section 1317 of the Revenue Act of 1918.

PART II A.

INCOME TAX ON CORPORATIONS.

TAX ON CORPORATIONS.

SEC. 230. (a) That, in lieu of the taxes imposed by section 10 of the Revenue Act of 1916, as amended by the Revenue Act of 1917, and by section 4 of the Revenue Act of 1917, there shall be levied, collected, and paid for each taxable year upon the net income of every corporation a tax at the following rates:

(1) For the calendar year 1918, 12 per centum of the amount of the net income in excess of the credits provided in section 236; and

(2) For each calendar year thereafter, 10 per centum of such excess amount.

(b) For the purposes of the Act approved March 21, 1918, entitled "An Act to provide for the operation of transportation systems while under Federal control, for the just compensation of their owners, and for other purposes," five-sixths of the tax imposed by paragraph (1) of subdivision (a) and four-fifths of the tax imposed by paragraph (2) of subdivision (a) shall be treated as levied by an Act in amendment of Title I of the Revenue Act of 1917.

ART. 501. **Income tax on corporations.**—The statute imposes an income tax at a fixed rate on all corporations not expressly exempt. See section 231 of the statute. The tax is upon net income, as defined in the statute, after deducting from gross income, as defined in the statute, the allowable deductions. See sections 232, 233, 234, and 235. Certain credits are allowed against net income and against the amount of the tax. See sections 236 and 238. The tax is payable upon the basis of returns rendered by the corporations liable thereto, except that in some cases it is to be paid at the source of the income. See sections 237, 239, 240, and 241. The statute also imposes on corporations a war profits and excess profits tax. See Part II B of the regulations. For the income tax on individuals, for administrative provisions, and for definitions and general provisions, see Parts I, III, and IV of the regulations.

ART. 502. **Rates of tax.**—The income tax on corporations is at the rate of 12 per cent of the net income subject to tax for the calendar year 1918 and at the rate of 10 per cent of the net income subject to tax for the calendar year 1919 and subsequent years. In order to determine the amount subject to tax the net income, as defined in section 232 of the statute and article 531 of the regulations, is first entitled to the credits specified in section 236 of the statute and article 591.

ART. 503. **Corporations liable to tax.**—Every corporation, domestic or foreign, not exempt under section 231 of the statute, is liable to the tax. It makes no difference that a domestic corporation may receive no income from sources within the United States. On the other hand, a foreign corporation is taxed only on its income from sources within the United States. See section 233 of the statute and article 550. For what the term "corporation" includes and for the difference between domestic and foreign corporations see section 1 and articles 1501–1509.

ART. 504. **Tax on transportation corporations.**—The Act to provide for the operation of transportation systems while under Federal control, for the just compensation of their owners, and for other purposes, of March 21, 1918, authorizes the President to agree with carriers for their just compensation and provides:

> Every such agreement shall provide that any Federal taxes under the Act of October third, nineteen hundred and seventeen, or Acts in addition thereto or in amendment thereof, commonly called war taxes, assessed for the period of Federal control beginning January first, nineteen hundred and eighteen, or any part of such period, shall be paid by the carrier out of its own funds, or shall be charged against or deducted from the just compensation; that other taxes assessed under Federal or any other governmental authority for the period of Federal control or any part thereof, either on the property used under such Federal control or on the right to operate as a carrier, or on the revenues or any part thereof derived from operation (not including, however, assessments for public improvements or taxes assessed on property under construction, and chargeable under the classification of the Interstate Commerce Commission to investment in road and equipment), shall be paid out of revenues derived from railway operations while under Federal control; that all taxes assessed under Federal or any other governmental authority for the period prior to January first, nineteen hundred and eighteen, whenever levied or payable, shall be paid by the carrier out of its own funds, or shall be charged against or deducted from the just compensation.

CONDITIONAL AND OTHER EXEMPTIONS.

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

(1) Labor, agricultural, or horticultural organizations;

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

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

(4) Domestic building and loan associations and cooperative banks without capital stock organized and operated for mutual purposes and without profit;

(5) Cemetery companies owned and operated exclusively for the benefit of their members;

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

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

(8) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare;

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

(10) Farmers' or other mutual hail, cyclone, or fire insurance companies, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting expenses;

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

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

(13) Federal land banks and national farm-loan associations as provided in section 26 of the Act approved July 17, 1916, entitled "An Act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgage, to equalize rates of interest upon farm loans, to furnish a market for United States bonds, to create Government depositaries and financial agents for the United States, and for other purposes";

(14) Personal service corporations.

ART. 511. **Proof of exemption.**—In order to establish its exemption, and thus be relieved of the duty of filing returns of income and paying the tax, it is necessary that every organization claiming exemption, except personal service corporations, file an affidavit with the collector of the district in which it is located, showing the character of the organization, the purpose for which it was organized, the sources of its income and its disposition, whether or not any of its income is credited to surplus or may inure to the benefit of any private stockholder or individual, and in general all facts relating to its operations which affect its right to exemption. To such affidavit should be attached a copy of the charter or articles of incorporation and by-laws of the organization. Upon receipt of the affidavit and other papers by the collector, he will inform the organization whether or not it is exempt. If, however, the collector is in doubt as to the taxable status of the organization, he will refer the affidavit and accompanying papers to the Commissioner for decision. When an organization has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or the purpose for which it was originally created. Collectors will keep a list of all exempt corporations, to the end that they may occasionally inquire into their status and ascertain whether or not they are observing the conditions upon which their exemption is predicated. As to personal service corporations see section 218 of the statute and articles 328–335.

ART. 512. **Agricultural and horticultural organizations.**—Agricultural or horticultural organizations exempt from tax do not include corporations engaged in growing agricultural or horticultural products or raising live stock or similar products for profit, but include only those organizations which, having no net income inuring to the benefit of their members, are educational or instructive in character and have for their purpose the betterment of the conditions of those engaged in these pursuits, the improvement of the grade of their products, and the encouragement and promotion of these industries to a higher degree of efficiency. Included in this class as exempt are organizations such as county fairs and like associations of a quasi-public character, which through a system of awards, prizes, or premiums are designed to encourage the production of better live stock, better agricultural and horticultural products, and whose income, derived from gate receipts, entry fees, donations, etc., is used exclusively to meet the necessary expenses of upkeep and operation. Societies or associations which have for their purpose the holding of annual or periodical race meets, from which profits inure or may inure to the benefit of the members or stockholders, do not come within the terms of this exemption. A corporation engaged in the business of raising stock or poultry, or growing grain, fruits, or other products of this character, as a means of livelihood and for the purpose of gain, is an agricultural or horticultural society only in the sense that its name indicates the kind of business in which it is engaged, and it is not exempt from tax.

ART. 513. **Mutual savings banks.**—A Massachusetts savings bank, otherwise exempt, which establishes an insurance department under the statutes of that State, does not thereby become subject to tax upon the income received by such department.

ART. 514. **Fraternal beneficiary societies.**—A fraternal beneficiary society is exempt from tax only if operated under the "lodge system," or for the exclusive benefit of the members of a society so operating.

"Operating under the lodge system" means carrying on its activities under a form of organization that comprises local branches, chartered by a parent organization and largely self-governing, called lodges, chapters, or the like. In order to be exempt it is also necessary that the society have an established system for the payment to its members or their dependents of life, sick, accident, or other benefits.

ART. 515. **Building and loan associations and cooperative banks.**—In general, a building and loan association entitled to exemption is one organized pursuant to the laws of the United States or of some State or Territory thereof, which accumulates funds to be loaned to its members and to be repaid in small periodical installments, and in which the members of the association share in the profits on substantially the same footing. It does not prevent exemption that the association issues prepaid stock entitled to a specified percentage of the profits. Where a building and loan association has no other features which render it liable to income tax, it will ordinarily not be subject to tax merely because—

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

(2) Its balance sheets show that it is lending considerable sums to nonmembers, or

(3) It is a regular borrower of large sums of money which it uses for loans to members, the dues paid by members being entirely inadequate for the business transacted by it.

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

ART. 516. **Cemetery companies.**—A cemetery company which is operated for profit or for the benefit of others than its members, does not come within the exempted class. A cemetery company of which all lot owners are members, issuing preferred stock entitling the holder to a semiannual dividend of four per cent, and whose articles of incorporation provide that the preferred stock shall be retired at par as soon as sufficient funds are realized from sales and that all funds realized in addition thereto shall be used by the company for the care and improvement of the cemetery property, is within the exemption.

ART. 517. **Religious, charitable, scientific, and educational corporations.**—The exemption applies only to a corporation, including an association. It does not include the case of a trust, under which the trustee is authorized to use the trust property for religious purposes. In order to be exempt, the corporation or association must meet three tests: (*a*) it must be organized and operated for one or more of the specified purposes; (*b*) it must be organized and operated exclusively for such purposes; and (*c*) no part of its income must inure to the benefit of private stockholders or individuals.

(1) Charitable corporations include an association for the relief of the families of clergymen, even though the latter make a contribution to the fund established for this purpose; or for furnishing the services of trained nurses to persons unable to pay for them; or for aiding the general body of litigants by improving the efficient administration of justice. Educational corporations may include an association whose sole purpose is the instruction of the public. This is true of an association to promote acquaintance with the Spanish language and literature, although it has incidental amusement features; of an association to increase knowledge of the civilization of another country; and of a Chautauqua association whose primary purpose is to give lectures on subjects useful to the individual and beneficial to the community and whose amusement features are incidental to this purpose. But associations formed to disseminate controversial or partisan propaganda are not educational within the meaning of the statute. Scientific corporations include an association for the scientific study of law, to the end of improvement in its administration.

(2) Where a religious corporation owns a large quantity of farm land and works it, and also manufactures and sells clothing and other articles for profit, it is not operated exclusively for religious purposes and is not exempt, even though its property is held in common and its profits do not inure to the benefit of individual members of the society.

(3) It does not prevent exemption that private individuals, for whose benefit a charity is organized, receive the income of the corporation or association. The statute refers to individuals having a personal and private interest in the activities of the corporation, such as stockholders. If, however, a corporation issues "voting shares," which entitle the holders upon the dissolution of the corporation to receive the proceeds of its property, including accumulated income, the right to exemption does not exist, even though the bylaws provide that the shareholders shall not receive any dividend or other return upon their shares.

ART. 518. **Business leagues.**—A business league is an association of persons having some common business interest, which limits its activities to work for such common interest and does not engage in a regular business of a kind ordinarily carried on for profit. Its work need not be similar to that of a chamber of commerce or board of trade. An association engaged in furnishing information to prospective investors, to enable them to make sound investments, is not such a league, since its members have no common business interest, and it is not exempt, even though all of its income is devoted to the purpose stated. A clearing house association, not organized for profit, no part of the net income of which inures to any private stockholder or individual, is exempt provided its activities are limited to the exchange of checks and similar work for the common benefit of its members. An association of persons who are engaged in the business of carrying freight and passengers by boats propelled by steam, which is designed to promote the legitimate objects of such business, and all of the income of which is derived from membership dues and is expended for office expenses and the salary of a secretary-treasurer, is exempt from tax. An incorporated cotton exchange, whose shares carry the right to dividends, is organized for profit and is not exempt.

ART. 519. **Civic leagues.**—A corporation having capital stock and possessing a charter which authorizes it to buy, improve, and sell real estate is organized for profit within the meaning of the statute and is not exempt from tax as a civic league or organization, even though it no longer exercises such powers for profit and is operated exclusively for the promotion of social welfare.

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

ART. 521. **Mutual insurance companies and like organizations.**—It is necessary to exemption that the income of the company be derived solely from assessments, dues and fees collected from members. If income is received from other sources, such as cash premiums or premium deposits, the corporation is not exempt, even though its additional income is tax exempt. Income, however, from sources other than those specified does not prevent exemption where its receipt is a mere incident of the business of the company. Thus the receipt of interest upon a working bank balance, or of the proceeds of the sale of badges, office supplies or equipment, will not defeat the exemption. The same is true of the receipt of interest upon liberty bonds, where they were purchased as a patriotic duty and were afterwards sold. Where, however, such bonds are bought as a permanent investment, the receipt of the interest destroys the exemption. The receipt of what is in substance an entrance fee, charged by a mutual fire insurance company as a condition of membership, does not render the company taxable, although this fee is called a premium. But the issuance of policies for stipulated cash premiums prevents exemption. A local exchange or association to insure the owners of automobiles against fire, theft, collision, public liability and property damage, is exempt, since it performs functions of the same character as a mutual fire insurance company, and is a like organization within the meaning of the statute. A local reservoir and ditch company may likewise be exempt from tax. The exemption does not include a telephone clearing association, whose business is to apportion toll rates between independent telephone companies handling the same calls and whose income consists of compensation paid by such companies and receipts from the sale of form blanks. The phrase "of a purely local character" qualifies only "like organizations." An organization of a "purely local character" is one whose business activities are confined to a particular community, place or district, irrespective, however, of political subdivisions. The word "purely" intensifies and limits "local," and indicates a clear intention on the part of Congress to exempt from taxation only such "like organizations" as are entirely and unqualifiedly "local" in their operations.

ART. 522. **Cooperative associations.**—(*a*) Cooperative associations, acting as sales agents for farmers or others, in order to come within the exemption must establish that for their own account they have no net income. Cooperative dairy companies, which are engaged in collecting milk and disposing of it or the products thereof and distributing the proceeds, less necessary operating expenses, among their members upon the basis of the quantity of milk or of butter fat in the milk furnished by such members, are exempt from the tax. If the proceeds of the business are distributed in any other way than on such a proportionate basis, the company will be subject to tax. A farmers' association is not exempt from taxation where in accounting to farmers furnishing produce for the proceeds of sales it deducts more than the necessary selling expenses incurred. A corporation organized to act as a sales agent for farmers and having a capital stock on which it pays a fixed dividend amounting to the legal rate of interest, all of the capital stock being owned by such owners, will not for that reason be denied exemption. (*b*) Cooperative associations acting as purchasing agents are not expressly exempt from tax and must make returns of income, but rebates made to purchasers, whether or not members of the association, in proportion to their purchases may be excluded from gross income in computing the net income subject to tax. Any profits made from nonmembers and distributed to members in the guise of rebates are, of course, subject to tax.

NET INCOME DEFINED.

SEC. 232. That in the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by section 234, and the net income shall be computed on the same basis as is provided in subdivision (b) of section 212 or in section 226.

ART. 531. **Net income.**—Net income is that portion of the gross income which remains after all proper deductions have been taken into account. The net income of corporations is determined in general in the same manner as the net income of individuals, but the deductions allowed corporations are not precisely the same as those allowed individuals. See sections 233, 234, and 235 of the statute. The net income of corporations is to be computed on the same basis as to accounting periods as the net income of individuals. See sections 212 and 226 and articles 21–26 and 431.

GROSS INCOME DEFINED.

SEC. 233. (a) That in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in section 213, except that:

(1) In the case of life insurance companies there shall not be included in gross income such portion of any actual premium received from any individual policyholder as is paid back or credited to or treated as an abatement of premium of such policyholder within the taxable year.

(2) Mutual marine insurance companies shall include in gross income the gross premiums collected and received by them less amounts paid for reinsurance.

(b) In the case of a foreign corporation gross income includes only the gross income from sources within the United States, including the interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, dividends from resident corporations, and including all amounts received (although paid under a contract for the sale of goods or otherwise) representing profits on the manufacture and disposition of goods within the United States.

ART. 541. **Gross income.**—The gross income of a corporation for the purpose of the tax in general includes and excludes the same things as the gross income of an individual. It embraces not only the operating revenues, but also gains, profits and income from all other sources, such as rentals, royalties, interest, dividends from stock in other corporations, and profits from the sale of capital assets.

The proceeds of life insurance policies paid upon the death of the insured to a corporation beneficiary, less any premiums paid by the corporation and not deducted from gross income, are to be included in its gross income. See sections 213 and 215 of the statute and articles 31–88 and 294. But in the case of life and mutual marine insurance companies and of foreign corporations there are special provisions. See articles 548–550.

ART. 541(a). **Creation of sinking fund.**—If a corporation, in order solely to secure the payment of its bonds or other indebtedness, places property in trust, or sets aside certain amounts in a sinking fund under the control of a trustee, who may be authorized to invest and reinvest such sums from time to time, the property or fund thus set aside by the corporation and held by the trustee is an asset of the corporation, and any gain arising therefrom is income of the corporation and shall be included as such in its annual return. The trustee, however, is not taxable as such on account of the property or fund so held. See section 219 and articles 341 to 347. If such fund is invested by the trustee in whole or in part in bonds, the trustee when presenting coupons from the bonds for payment shall file ownership certificates, form 1001 (revised), whether or not the bonds contain a tax-free covenant clause. See article 366.

ART. 542. **Sale of capital stock.**—The proceeds from the original sale by a corporation of its shares of capital stock, whether such proceeds are in excess of or less than the par value of the stock issued, constitute the capital of the company. If the stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount is not a loss deductible from gross income. If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the stockholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase of its own stock. See articles 563, 861, and 862.

ART. 543. **Contributions by stockholders.**—Where a corporation requires additional funds for conducting its business and obtains such needed money through voluntary pro rata payments by its stockholders, the amounts so received being credited to its surplus account or to a special capital account, such amounts will not be considered income, although there is no increase in the outstanding shares of stock of the corporation. The payments in such circumstances are in the nature of voluntary assessments upon, and represent an additional price paid for, the shares of stock held by the individual stockholders, and will be treated as an addition to and as a part of the operating capital of the company. See articles 51, 293, 838, and 860.

ART. 544. **Sale and retirement of corporate bonds.**—(1) (*a*) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. See section 234 of the statute and article 563. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.

(2) (*a*) If bonds are issued by a corporation at a premium, the net amount of such premium is gain or income which should be prorated or amortized over the life of the bonds. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price minus any amount of premium already returned as income, the excess of the purchase price over the issuing price minus any amount of premium already returned as income (or over the face value plus any amount of premium not yet returned as income) is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price minus any amount of premium already returned as income, the excess of the issuing price minus any amount of premium already returned as income (or of the face value plus any amount of premium not yet returned as income) over the purchase price is gain or income for the taxable year.

(3) (*a*) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or over the face value minus any amount of discount not yet deducted) is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price plus any amount of discount already deducted, the excess of the issuing price plus any amount of discount already deducted (or of the face value minus any amount of discount not yet deducted) over the purchase price is gain or income for the taxable year.

Art. 545. **Sale of capital assets.**—Where property is acquired and later sold for a higher price, the gain on the sale is income. If, however, the property was acquired before March 1, 1913, only such portion of the gain as accrued subsequently to February 28, 1913, is taxable. Where, then, a corporation sells its capital assets in whole or in part, it shall include in its gross income for the year in which the sale was made the amount of the excess of the sales price over the fair market value of such assets as of March 1, 1913, if acquired prior to that date, or over their cost if acquired on or after that date. In every case, however, in ascertaining the gain, the cost of the assets, or the fair market value as of March 1, 1913, of the assets acquired prior thereto, should first be reduced by the amount of any charges for depreciation, depletion, and other losses which have been or should have been made. If the purchaser takes over all the assets and assumes the liabilities, the amount so assumed is part of the purchase price. See also article 563. If the sale is made for stock of another corporation, the rules contained in section 202 of the statute and in articles 1561–1570 are particularly applicable.

Art. 546. **Income from leased property.**—Where a corporation has leased its property in consideration that the lessee shall pay in lieu of other rental an amount equivalent to a certain rate of dividend on the lessor's capital stock or the interest on the lessor's outstanding indebtedness, together with taxes, insurance, or other fixed charges, such payments shall be considered rental payments and shall be returned by the lessor corporation as income, notwithstanding the fact that the dividends and interest are paid by the lessee directly to the stockholders and bondholders of the lessor. The fact that a corporation has conveyed or let its property and has parted with its management and control, or has ceased to engage in the business for which it was originally organized, will not relieve it from liability to the tax. While the payments made by the lessee directly to the bondholders or stockholders of the lessor are rentals as to both the lessee and lessor (rentals paid in one case and rentals received in the other), to the bondholders and the stockholders such amounts are interest and dividend payments received as from the lessor and as such shall be accounted for in their returns.

Art. 547. **Gross income of corporation in liquidation.**—When a corporation is dissolved, its affairs are usually wound up by a receiver or trustees in dissolution. The corporate existence is continued for the purpose of liquidating the assets and paying the debts, and such receiver or trustees stand in the stead of the corporation for such purposes. Any sales of property by them are to be treated as if made by the corporation for the purpose of ascertaining the gain or loss. No gain or loss is realized by a corporation from the mere distribution of its assets in kind upon dissolution, however they may have appreciated or depreciated in value since their acquisition. See further articles 622 and 1548.

ART. 548. **Gross income of insurance companies.**—The gross income of insurance companies consists of their total revenue from the operation of the business and of their income from all other sources within the taxable year, except as otherwise provided by the statute. Gross income includes net premiums (that is, gross premiums less returned premiums on policies cancelled and premiums on policies not taken), investment income, profits from the sale of assets, and all gains, profits, and income reported to the State insurance departments, except income specifically exempt from tax. Premiums received by mutual marine insurance companies which are paid out for reinsurance should be eliminated from gross income and the payments for reinsurance from disbursements. Deposit premiums on perpetual risks received and returned by fire insurance companies should be treated in the same manner, as no reserve will be recognized covering liability for such deposits. The earnings on such deposits, including such portion, if any, of the deposits as are not returned to the policyholders upon cancellation of the policies, must be included in the gross income. A net decrease in reserve funds required by law within the taxable year must be included in the gross income to the extent that it is released to the general uses of the company and increases its free assets. Any net decrease in reserves shall be added to the gross income, unless the company shall show that such decrease resulted from the application of reserves to the purposes for which they were established. See articles 568–572.

ART. 549. **Gross income of life insurance companies.**—A life insurance company shall not include in gross income such portion of any actual premium received from any individual policyholder as is paid back or credited to or treated as an abatement of premium of such policyholder within the taxable year. (*a*) "Paid back" means paid in cash. (*b*) "Credited to" means applied by way of credit to the payment of the premium for the taxable year. It does not include dividends applied to purchase additional paid-up insurance or annuities, or to shorten the endowment or premium paying period, or in any way that does not actually reduce the premium receipts of the company for the taxable year. (*c*) "Treated as an abatement of premium" means of the premium for the taxable year. Where the dividend paid back is in excess of the premium received from the policyholder within the taxable year there may be excluded from gross income only the amount of such premium received, and where no premium is received from the policyholder within the taxable year the company is not entitled to exclude from its premiums received from other policyholders any amount in respect of such dividend payment.

ART. 550. **Gross income of foreign corporations.**—The gross income of a foreign corporation, including an insurance company, means its gross income from sources within the United States, as defined and described in articles 91–93 relating to nonresident alien individuals. The income from business relating to a foreign country which is transacted by a United States branch or agency of a foreign insurance company must be returned as gross income.

DEDUCTIONS ALLOWED.

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

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

(2) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917) the interest upon which is wholly exempt from taxation under this title as income to the taxpayer, or, in the case of a foreign corporation, the proportion of such interest which the amount of its gross income from sources within the United States bears to the amount of its gross income from all sources within and without the United States;

(3) Taxes paid or accrued within the taxable year imposed (a) by the authority of the United States, except income, war-profits and excess-profits taxes; or (b) by the authority of any of its possessions, except the amount of income, war-profits and excess-profits taxes allowed as a credit under section 238; or (c) by the authority of any State or Territory, or any county, school district, municipality, or other taxing subdivision of any State or Territory, not including those assessed against local benefits of a kind tending to increase the value of the property assessed; or (d) in the case of a domestic corporation, by the authority of any foreign country, except the amount of income, war-profits and excess-profits taxes allowed as a credit under section 238; or (e) in the case of a foreign corporation, by the authority of any foreign country (except income, war-profits and excess-profits taxes, and taxes assessed against local benefits of a kind tending to increase the value of the property assessed), upon the property or business: *Provided*, That in the case of obligors specified in subdivision (b) of section 221 no deduction for the payment of the tax imposed by this title or any other tax paid pursuant to the contract or provision referred to in that subdivision, shall be allowed;

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;

(5) Debts ascertained to be worthless and charged off within the taxable year;

(6) Amounts received as dividends from a corporation which is taxable under this title upon its net income, and amounts received as dividends from a personal service corporation out of earnings or profits upon which income tax has been imposed by Act of Congress;

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

(8) In the case of buildings, machinery, equipment, or other facilities, constructed, erected, installed, or acquired, on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war, and in the case of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of the present war, there shall be allowed a reasonable deduction for the amortization of such part of the cost of such facilities or vessels as has been borne by the taxpayer, but not again including any amount otherwise allowed under this title or previous acts of Congress as a deduction in computing net income. At any time within three years after the termination of the present war the Commissioner may, and at the request of the taxpayer shall, reexamine the return, and if he then finds as a result of an appraisal or from other evidence that the deduction originally allowed was incorrect, the taxes imposed by this title and by Title III for the year or years affected shall be redetermined and the amount of tax due upon such redetermination, if any, shall be paid upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 252;

(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided*, That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further*, That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee;

(10) In the case of insurance companies, in addition to the above: (a) The net addition required by law to be made within the taxable year to reserve funds (including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds); and (b) the sums other than dividends paid within the taxable year on policy and annuity contracts;

(11) In the case of corporations issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan continuing for life and not subject to cancellation, in addition to the above, such portion of the net addition (not required by law) made within the taxable year to reserve funds as the Commissioner finds to be required for the protection of the holders of such policies only;

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

(13) In the case of mutual insurance companies (other than mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, there shall be allowed, in addition to the deductions allowed in paragraphs (1) to (10), inclusive, (unless otherwise allowed under such paragraphs) the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves;

(14) (a) At the time of filing return for the taxable year 1918 a taxpayer may file a claim in abatement based on the fact that he has sustained a substantial loss (whether or not actually realized by sale or other disposition) resulting from any material reduction (not due to temporary fluctuation) of the value of the inventory for such taxable year, or from the actual payment after the close of such taxable year of rebates in pursuance of contracts entered into during such year upon sales made during such year. In such case payment of the amount of the tax covered by such claim shall not be required until the claim is decided, but the taxpayer shall accompany his claim with a bond in double the amount of the tax covered by the claim, with sureties satisfactory to the Commissioner, conditioned for the payment of any part of such tax found to be due, with interest. If any part of such claim is disallowed then the remainder of the tax due shall on notice and demand by the collector be paid by the taxpayer with interest at the rate of 1 per centum per month from the time the tax would have been due had no such claim been filed. If it is shown to the satisfaction of the Commissioner that such substantial loss has been sustained, then in computing the taxes imposed by this title and by Title III the amount of such loss shall be deducted from the net income. (b) If no such claim is filed, but it is shown to the satisfaction of the Commissioner that during the taxable year 1919 the taxpayer has sustained a substantial loss of the character above described then the amount of such loss shall be deducted from the net income for the taxable year 1918 and the taxes imposed by this title and by Title III for such year shall be redetermined accordingly. Any amount found to be due to the taxpayer upon the basis of such redetermination shall be credited or refunded to the taxpayer in accordance with the provisions of section 252.

(b) In the case of a foreign corporation the deductions allowed in subdivision (a), except those allowed in paragraph (2) and in clauses (a), (b), and (c) of paragraph (3), shall be allowed only if and to the extent that they are connected with income arising from a source within the United States; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

ART. 561. **Allowable deductions.**—In general the deductions from gross income allowed corporations are the same as allowed individuals, except that corporations may deduct dividends received from other corporations subject to the tax and may not deduct charitable contributions, and that insurance companies are permitted special deductions. See section 214 of the statute. Particularly, as to business expenses see articles 101–111; as to interest paid see articles 121 and 122; as to taxes paid see articles 131–134; as to losses see articles 141–145; as to bad debts see articles 151–154; as to depreciation see articles 161–171; as to amortization see articles 181–188; as to depletion see articles 201–237; and as to loss in inventory see articles 261–268.

ART. 562. **Donations.**—Corporations are not entitled to deduct from gross income contributions made to religious, charitable, scientific, or educational corporations, even though such contributions are made to the Red Cross or other war activities. Donations made by a corporation for purposes connected with the operation of its business, when limited to charitable institutions, hospitals, or educational institutions conducted for the benefit of its employees or their dependents, are a proper deduction as ordinary and necessary expenses. Donations which legitimately represent a consideration for a benefit flowing directly to the corporation as an incident of its business are allowable deductions from gross income. For example, a street railway corporation may donate a sum of money to an organization intending to hold a convention in the city in which it operates, with the reasonable expectation that the holding of such convention will augment its income through a greater number of people using the cars. Expenses incurred in advertising and promoting the sale of liberty bonds and war savings stamps over the corporation's name are deductible. Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses, are not deductible from gross income.

ART. 563. **Sale of capital stock, bonds, and capital assets.**—A corporation sustains no deductible loss from the sale of its capital stock. See article 542. If it sells its bonds at a discount, the amount of such discount is treated in the same way as interest paid, and if it retires its bonds at a price in excess of the issuing price, such excess may usually be deducted as expense. See articles 544 and 848. If the corporation sells its capital assets for less than their cost or fair market value as of March 1, 1913, the loss sustained is deductible. See article 545.

ART. 564. **Interest.**—Interest paid by a corporation on scrip dividends is an allowable deduction. So-called interest on preferred stock, which is in reality a dividend thereon, can not be deducted in arriving at net income. In the case of banks and loan or trust companies interest paid within the year on deposits or on moneys received for investment and secured by interest-bearing certificates of indebtedness issued by such bank or loan or trust company may be deducted from gross income.

ART. 565. **Effect of tax-free covenant in bonds.**—Corporations may deduct taxes from gross income to the same extent as individuals, except that in the case of corporate bonds or obligations containing a tax-free covenant clause, the corporation paying a federal tax, or any part of it, for some one else pursuant to its agreement is not entitled to deduct such payment from gross income on any ground. In the case, however, of corporate bonds or obligations containing an appropriate tax-free covenant clause, the corporation paying a State tax or any other than a federal tax for some one else pursuant to its agreement may deduct such payment as interest paid on indebtedness.

ART. 566. **Tax on bank stock.**—Banks paying taxes assessed against their stockholders on account of their ownership of the shares of stock issued by such banks can not deduct the amount of taxes so paid. The shares of stock being the property of the stockholders, to the extent that the taxes assessed on the value of the shares of stock are property taxes the holders are primarily liable for their payment. As federal statutes prohibit States from imposing any tax upon national banks except upon the value of their real estate, in cases where States levy a tax on the stock of such banks and make it the duty of the banks to pay such tax for the stockholders it is clear that such payments are not deductible from the gross income of such banks. This rule applies also in the case of corporations other than banks, upon the value of whose stock taxes are assessed to the stockholders. Such payments by banks or other corporations are regarded as in the nature of additional dividends and must be included by the stockholder in his dividends received, but he may deduct from gross income the taxes so paid in his behalf. See articles 565 and 134.

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

ART. 568. **Deductions allowed insurance companies.**—Insurance companies are entitled to the same deductions from gross income as other corporations, and also to the deduction of the net addition required by law to be made within the taxable year to reserve funds and of the sums other than dividends paid within the taxable year on policy and annuity contracts. "Paid" includes "accrued" or "incurred" (construed according to the method of accounting upon the basis of which the net income is computed) during the taxable year, but does not include any estimate for losses incurred but not reported during the taxable year. As payments on policies there should be reported all death, disability and other policy claims (other than dividends as above specified) paid within the year, including fire, accident, and liability losses, matured endowments, annuities, payments on installment policies and surrender values actually paid. See also article 566.

ART. 569. **Required addition to reserve funds of insurance companies.**—Insurance companies may deduct from gross income the net addition required by law to be made within the taxable year to reserve funds, including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds. Reserve funds "required by law" include not only reserves required by express statutory provisions, but also reserves required by the rules and regulations of State insurance departments when promulgated in the exercise of an appropriate power conferred by statute, but do not include assets required to be held for the ordinary running expenses of the business, such as taxes, salaries, reinsurance, and unpaid brokerage. Only reserves commonly recognized as reserve funds in insurance accounting are to be taken into consideration in computing the net addition to reserve funds required by law. In the case of a fire insurance company the only reserve fund commonly recognized is the "unearned-premium" fund. Casualty companies may deduct losses incurred within the taxable year; but unless the net addition to the unpaid loss reserve required by law exceeds such losses incurred, no deduction for the net addition to the unpaid loss reserve may be taken. In any event only the excess of such net addition over such losses may be deducted. In the case of life insurance companies the net addition to the "reinsurance reserve" and the "reserve for supplementary contracts not involving life contingencies," and the net addition to any other reserve funds necessarily maintained for the purpose of liquidating policies at maturity, are legally deductible. An increase in the reserve maintained by a life insurance company to pay dividends on deferred dividend policies may be deducted from gross income when such reserve is required by law. Mutual hail and mutual cyclone insurance companies are entitled to deduct from gross income the net addition which they are required to make to the "guaranty surplus" fund or similar fund.

ART. 570. **Special deductions allowed in the case of combined life, health, and accident policies.**—Corporations which issue combination policies of life, health, and accident insurance on the weekly premium payment plan, continuing for life and not subject to cancellation, may deduct from gross income only such portion of the net addition not required by law made within the taxable year to reserve funds as is needed for the protection of the holders of such combination policies. In general the net addition to any fund especially maintained for the protection of such policyholders may be deducted. The determination by the company of the need for such addition is subject to review by the Commissioner, and the return of income should be accompanied by a full explanation of the basis upon which such fund and the additions to it are determined.

ART. 571. **Special deductions allowed mutual marine insurance companies.**—Mutual marine insurance companies should include in gross income the gross premiums collected and received by them less amounts paid for reinsurance. See section 233 of the statute and article 548. They may deduct from gross income amounts repaid to policyholders on account of premiums previously paid by them, together with the interest actually paid upon such amounts between the date of ascertainment and the date of payment thereof. The remainder of the premiums accordingly form part of the net income of the company, except to the extent that they are subject to the deductions allowed insurance companies in general and other corporations.

ART. 572. **Special deductions allowed mutual insurance companies.**—Mutual insurance companies (other than mutual life and mutual marine insurance companies), which require their members to make premium deposits to provide for losses and expenses, are allowed to deduct from gross income the aggregate amount of premium deposits returned to their policyholders or retained for the payment of losses, expenses, and reinsurance reserves. In determining the amount of premium deposits retained by a mutual fire or mutual casualty insurance company for the payment of losses, expenses, and reinsurance reserves, it will be presumed that losses and expenses have been paid out of earnings and profits other than premiums to the extent of such earnings and profits. If, however, any portion of such amount is applied during the taxable year to the payment of losses, expenses, or reinsurance reserves, for which a separate allowance is taken, then such portion is not deductible; and if any portion of such amount for which an allowance is taken is subsequently applied to the payment of expenses, losses, or reinsurance reserves, then such payment can not be separately deducted. An amount of premium deposits retained for the payment of expenses and losses, and the amount of such expenses and losses, may not both be deducted. A company which invests part of the premium deposits so retained by it in interest-bearing securities may nevertheless deduct such part, but not the interest received on such securities. A mutual fire insurance company which has a guaranty capital is taxed like other mutual fire insurance companies. A stock fire insurance company, operated on the mutual plan to the extent of paying dividends to certain classes of policyholders, may make a return on the same basis as a mutual fire insurance company with respect to its business conducted on the mutual plan.

ART. 573. **Deductions allowed foreign corporations.**—Foreign corporations are allowed the same deductions from their gross income arising from sources within the United States as are allowed to domestic corporations, to the extent that such deductions are connected with such gross income, with the exception that the interest deductible is that proportion of so much of the entire interest paid on the corporate indebtedness as would be deductible if paid by a domestic corporation which the gross income from sources within the United States bears to the total gross income, and that full deduction may be made for taxes imposed by the United States or any of its possessions, or by any State, Territory, or political subdivision thereof, except taxes for local benefits and income, war profits and excess profits taxes. A Canadian manufacturing corporation which sells part of its product in the United States and part in Canada should report its deductions for cost of manufacture, exclusive of interest paid on its indebtedness, in the same proportion as the quantity of its product sold in the United States bears to the total quantity sold. See section 214 (b) of the statute and article 271.

ITEMS NOT DEDUCTIBLE.

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

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

ART. 582. **Capital expenditures.**—Expenses of the organization of a corporation, such as incorporation fees and attorneys' and accountants' charges, constitute investments of capital and are not deductible from gross income. See article 818. A holding company which guarantees dividends at a specified rate on the stock of a subsidiary corporation for the purpose of securing new capital for the subsidiary and increasing the value of its stock holdings in the subsidiary may not deduct amounts paid in carrying out this guaranty in computing its net income, but such payments may be added to the cost of its stock in the subsidiary. But see article 868.

CREDITS ALLOWED.

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

(a) The amount received as interest upon obligations of the United States and bonds issued by the War Finance Corporation, which is included in gross income under section 233;

(b) The amount of any taxes imposed by Title III for the same taxable year: *Provided*, That in the case of a corporation which makes return for a fiscal year beginning in 1917 and ending in 1918, in computing the tax as provided in subdivision (a) of section 205, the tax computed for the entire period under Title II of the Revenue Act of 1917 shall be credited against the net income computed for the entire period under Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917 and under Title I of the Revenue Act of 1917, and the tax computed for the entire period under Title III of this Act at the rates prescribed for the calendar year 1918 shall be credited against the net income computed for the entire period under this title; and

(c) In the case of a domestic corporation, $2,000.

ART. 591. **Credits allowed.**—After ascertaining the net income of a domestic corporation it is allowed as credits against such net income before the application of the income tax rate the sum of $2,000, plus the amount of any war profits and excess profits tax assessed or to be assessed for the same taxable year, and plus the amount of interest not entirely exempt from tax received upon obligations of the United States and bonds of the War Finance Corporation. See section 213(b) of the statute and articles 77–82. Consequently, in the case of corporations no income tax is imposed on any interest received upon obligations of the United States or bonds of the War Finance Corporation. A foreign corporation is allowed the same credits other than the sum of $2,000. As to corporations with fiscal years beginning in 1917 see section 205 and article 1623. For the purpose of the war profits and excess profits tax a corporation is not entitled to these credits. See also section 216 and articles 301–307.

PAYMENT OF TAX AT SOURCE.

SEC. 237. That in the case of foreign corporations subject to taxation under this title not engaged in trade or business within the United States and not having any office or place of business therein, there shall be deducted and withheld at the source in the same manner and upon the same items of income as is provided in section 221 a tax equal to 10 per centum thereof, and such tax shall be returned and paid in the same manner and subject to the same conditions as provided in that section: *Provided*, That in the case of interest described in subdivision (b) of that section the deduction and withholding shall be at the rate of 2 per centum.

ART. 601. **Withholding in the case of nonresident foreign corporations.**—With respect to payments to foreign corporations not engaged in trade or business within the United States and not having any office or place of business therein, withholding is required of a tax of 2 per cent in the case of interest payable upon corporate bonds or other obligations containing a tax-free covenant clause, and of a tax of 10 per cent in the case of other fixed or determinable annual or periodical income, other than corporate dividends. See section 221 of the statute and articles 361–376. To enable debtors in the United States to distinguish between foreign corporations which have and those which have not any office or place of business in the United States, and also to enable such corporations as have an office or place of business in the United States to claim exemption from withholding the tax on bond interest or other income, a certificate stating that any such corporation has an office or place of business in the United States should be filed by it with the debtor.

CREDIT FOR TAXES.

SEC. 238. (a) That in the case of a domestic corporation the total taxes imposed for the taxable year by this title and by Title III shall be credited with the amount of any income, war-profits and excess-profits taxes paid during the taxable year to any foreign country, upon income derived from sources therein, or to any possession of the United States.

If accrued taxes when paid differ from the amounts claimed as credits by the corporation, or if any tax paid is refunded in whole or in part, the corporation shall at once notify the Commissioner who shall redetermine the amount of the taxes due under this title and under Title III for the year or years affected, and the amount of taxes due upon such redetermination, if any, shall be paid by the corporation upon notice and demand by the collector, or the amount of taxes overpaid, if any, shall be credited or refunded to the corporation in accordance with the provisions of section 252. In the case of such a tax accrued but not paid, the Commissioner as a condition precedent to the allowance of this credit may require the corporation to give a bond with sureties satisfactory to and to be approved by him in such penal sum as he may require, conditioned for the payment by the taxpayer of any amount of taxes found due upon any such redetermination; and the bond herein prescribed shall contain such further conditions as the Commissioner may require.

(b) This credit shall be allowed only if the taxpayer furnishes evidence satisfactory to the Commissioner showing the amount of income derived from sources within such foreign country or such possession of the United States, as the case may be, and all other information necessary for the computation of such credit.

(c) If a domestic corporation makes a return for a fiscal year beginning in 1917 and ending in 1918, only that proportion of this credit shall be allowed which the part of such period within the calendar year 1918 bears to the entire period.

Art. 611. **Credit for foreign taxes.**—For the meaning of the terms used in section 238 of the statute see section 1 and article 382. To secure such a credit a domestic corporation must pursue the same course as that prescribed for an individual by article 383, except that form 1118 is to be used for claiming credit and form 1119 for the bond, if a bond be required. For the redetermination of the tax, when a credit for such taxes has been rendered incorrect by later developments, see article 384, all of the provisions of which apply with equal force to a corporation taxpayer. For credit where taxes are paid by a foreign corporation controlled by a domestic corporation see article 636. A claim for credit in such a case is also to be made on form 1118.

CORPORATION RETURNS.

Sec. 239. That every corporation subject to taxation under this title and every personal service corporation shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer or assistant treasurer. If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return shall be made by the agent. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control.

Returns made under this section shall be subject to the provisions of sections 226 and 228. When return is made under section 226 the credit provided in subdivision (c) of section 236 shall be reduced to an amount which bears the same ratio to the full credit therein provided as the number of months in the period for which such return is made bears to twelve months.

Art. 621. **Corporation returns.**—Every corporation not expressly exempt from tax and every personal service corporation must make a return of income, regardless of the amount of its net income. In the case of ordinary corporations the return shall be on form 1120. For returns of insurance companies see article 623; of personal service corporations see article 624; of foreign corporations see article 625; and of affiliated corporations see section 240 of the statute and articles 631–638. A corporation having an existence during any portion of a taxable year is required to make a return. A corporation which has received a charter, but has never perfected its organization, and which has transacted no business and had no income from any source, may upon presentation of the facts to the collector be relieved from the necessity of making a return so long as it remains in an unorganized condition. In the absence of a proper showing to the collector such a corporation will be required to make a return. A corporation which was dissolved in 1918 or 1919 prior to the enactment of the present statute is not relieved from the necessity of rendering returns thereunder for 1918 and for such portion of 1919 as elapsed before its dissolution. See further section 228 of the statute and articles 406, 407, and 451.

Art. 622. **Returns by receivers.**—Receivers, trustees in dissolution, trustees in bankruptcy, and assignees, operating the property or business of corporations, must make returns of income for such corporations on form 1120, covering each year or part of a year during which they are in control. Notwithstanding that the powers and functions of a corporation are suspended and that the property and business are for the time being in the custody of the receiver, trustee, or assignee, subject to the order of the court, such receiver, trustee, or assignee stands in the place of the corporate officers and is required to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. A receiver in charge of only part of the property of a corporation, however, as a receiver in mortgage foreclosure proceedings involving merely a small portion of its property, need not make a return of income. See articles 424 and 547.

Art. 623. **Returns of insurance companies.**—Insurance companies transacting business in the United States or deriving an income from sources therein are required to file returns of income. The return shall be on form 1120. As an aid in auditing the returns, wherever possible a copy of the report to the State insurance department should be submitted with the return. Otherwise a copy of schedule D, parts 1, 3, and 4, of the report should be attached to the return, showing the federal, State, and municipal obligations from which the interest omitted from gross income was derived, and a copy of the complete report should be furnished as soon as ready for filing.

ART. 624. **Returns of personal service corporations.**—Every personal service corporation must make a return of income, regardless of the amount of its net income. The return shall be on form 1065 (revised). It shall be made for the taxable year of the personal service corporation; that is, for its annual accounting period (fiscal year or calendar year, as the case may be), regardless of the taxable years of its stockholders. See sections 200, 212, and 218 of the statute and articles 1523–1532, 25, 26, and 328–335. If the personal service corporation makes any change in its accounting period it shall render its return in accordance with the provisions of section 226 of the statute and article 431. The return of a personal service corporation shall state specifically (*a*) the items of its gross income enumerated in section 213 of the statute; (*b*) the deductions enumerated in section 214 of the statute, other than the deduction provided in paragraph (11) of subdivision (a) of that section; (*c*) the amount specified in subdivisions (a) and (b) of section 216 of the statute received by the personal service corporation; (*d*) the amount of any income, war profits and excess profits taxes of the personal service corporation paid during the taxable year to a foreign country or to any possession of the United States, and the amount of any such taxes accrued but not paid during the taxable year; (*e*) the amounts distributed by the corporation during its taxable year with the dates of distribution; (*f*) the names and addresses of the stockholders of the corporation at the close of its taxable year and their respective shares in such corporation; (*g*) such facts as tend to show whether or not the corporation is a personal service corporation; and (*h*) such other facts as are required by the form. A personal service corporation which makes a return for a fiscal year beginning in 1917 shall include therein all the facts required for the computation of income and excess profits taxes under Title I of the Revenue Act of 1916, as amended by the Revenue Act of 1917, and under Titles I and II of the Revenue Act of 1917. See sections 205 and 335 of the statute and articles 1621–1625 and 951.

ART. 625. **Returns of foreign corporations.**—Every foreign corporation having income from sources within the United States must make a return of income on form 1120. If such a corporation has no office or place of business here, but has a resident agent, he shall make the return. It is not necessary, however, for it to be required to make a return that the foreign corporation shall be engaged in business in this country or that it have any office, branch, or agency in the United States. See articles 404, 550, and 573.

ART. 626. **Returns for fractional part of year.**—In the case of a corporation making its first return of income on the basis of a fiscal year and in the case of a corporation changing its accounting period, whether from calendar year to fiscal year, from fiscal year to calendar year, or from one fiscal year to another fiscal year, a separate return for a fractional part of a year is required. See section 226 of the statute and article 431. In such a case the credit of $2,000 against net income allowed a domestic corporation shall be reduced to such proportion of the full credit as the number of months in the period for which the return is made bears to twelve months. See sections 236 and 305 and articles 591 and 761.

CONSOLIDATED RETURNS.

SEC. 240. (a) That corporations which are affiliated within the meaning of this section shall, under regulations to be prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income and invested capital for the purposes of this title and Title III, and the taxes thereunder shall be computed and determined upon the basis of such return: *Provided*, That there shall be taken out of such consolidated net income and invested capital, the net income and invested capital of any such affiliated corporation organized after August 1, 1914, and not successor to a then existing business, 50 per centum or more of whose gross income consists of gains, profits, commissions, or other income, derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive. In such case the corporation so taken out shall be separately assessed on the basis of its own invested capital and net income and the remainder of such affiliated group shall be assessed on the basis of the remaining consolidated invested capital and net income.

In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. There shall be allowed in computing the income tax only one specific credit of $2,000 (as provided in section 236); in computing the war-profits credit (as provided in section 311) only one specific exemption of $3,000; and in computing the excess-profits credit (as provided in section 312) only one specific exemption of $3,000.

(b) For the purpose of this section two or more domestic corporations shall be deemed to be affiliated (1) if one corporation owns directly or controls through closely affiliated interests or by a nominee or nominees substantially all the stock of the other or others, or (2) if substantially all the stock of two or more corporations is owned or controlled by the same interests.

(c) For the purposes of section 238 a domestic corporation which owns a majority of the voting stock of a foreign corporation shall be deemed to have paid the same proportion of any income, war-profits and excess-profits taxes paid (but not including taxes accrued) by such foreign corporation during the taxable year to any foreign country or to any possession of the United States upon income derived from sources without the United States, which the amount of any dividends (not deductible under section 234) received by such domestic corporation from such foreign corporation during the taxable year bears to the total taxable income of such foreign corporation upon or with respect to which such taxes were paid: *Provided,* That in no such case shall the amount of the credit for such taxes exceed the amount of such dividends (not deductible under section 234) received by such domestic corporation during the taxable year.

ART. 631. **Affiliated corporations.**—The provision of the statute requiring affiliated corporations to file consolidated returns is based upon the principle of levying the tax according to the true net income and invested capital of a single business enterprise, even though the business is operated through more than one corporation. Where one corporation owns the capital stock of another corporation or other corporations, or where the stock of two or more corporations is owned by the same interests, a situation results which is closely analogous to that of a business maintaining one or more branch establishments. In the latter case, because of the direct ownership of the property, the invested capital and net income of the branch form a part of the invested capital and net income of the entire organization. Where such branches or units of a business are owned and controlled through the medium of separate corporations, it is necessary to require a consolidated return in order that the invested capital and net income of the entire group may be accurately determined. Otherwise opportunity would be afforded for the evasion of taxation by the shifting of income through price fixing, charges for services and other means by which income could be arbitrarily assigned to one or another unit of the group. In other cases without a consolidated return excessive taxation might be imposed as a result of purely artificial conditions existing between corporations within a controlled group. See articles 785, 791, 802, and 864–869.

ART. 632. **Consolidated returns.**—Affiliated corporations, as defined in the statute and in article 633, are required to file consolidated returns on form 1120. The consolidated return shall be filed by the parent or principal reporting corporation in the office of the collector of the district in which it has its principal office. Each of the other affiliated corporations shall file in the office of the collector of its district form 1122, along with the several schedules indicated thereon. The parent or principal corporation filing a consolidated return shall include in such return a statement specifically setting forth (*a*) the name and address of each of the subsidiary or affiliated corporations included in such return, (*b*) the par value of the total outstanding capital stock of each of such corporations at the beginning of the taxable year, (*c*) the par value of such capital stock held by the parent corporation or by the same interests at the beginning of the taxable year, (*d*) in the case of affiliated corporations, the stock of which is owned or controlled by the same interests, a list of the individuals or partnerships constituting such interests, with the percentage of the total outstanding stock of each affiliated corporation held by each of such individuals or partnerships during all of the taxable year, and (*e*) a schedule showing the proportionate amount of the total tax which it is agreed among them is to be assessed upon each affiliated corporation. Foreign corporations and personal service corporations need not file consolidated returns. See article 1524.

ART. 633. **When corporations are affiliated.**—Corporations will be deemed to be affiliated (*a*) when one domestic corporation owns directly or controls through closely affiliated interests or by a nominee or nominees substantially all the stock of the other or others, or (*b*) when substantially all the stock of two or more domestic corporations is owned or controlled by the same interests. The words "substantially all the stock" can not be interpreted as meaning any particular percentage, but must be construed according to the facts of the particular case. The owning or controlling of 95 per cent or more of the outstanding voting capital stock (not including stock in the treasury) at the beginning of and during the taxable year will be deemed to constitute an affiliation within the meaning of the statute. Consolidated returns may, however, be required even though the stock ownership is less than 95 per cent. When the stock ownership or control is less than 95 per cent, but in excess of 50 per cent, a full disclosure of affiliations should be made, showing all pertinent facts, including the stock owned or controlled in each subsidiary or affiliated corporation and the percentage of such stock owned or controlled to the total stock outstanding. Such statement should preferably be made in advance of filing the return, with a request for instructions as to whether a consolidated return should be made. In any event such a statement should be filed as a part of the return. The words "the same interests" shall be deemed to mean the same individual or partnership or the same individuals or partnerships, but when the stock of two or more corporations is owned or controlled by two or more individuals or by two or more partnerships a consolidated return is not required unless the percentage of stock held by each individual or each partnership is substantially the same in each of the affiliated corporations.

ART. 634. **Change in ownership during taxable year.**—When one corporation owns or controls substantially all the stock of another corporation at the beginning of any taxable year, but during the taxable year sells or parts with the control of all or a majority of such stock to outside interests not affiliated with it, or when one corporation during any taxable year acquires the ownership or control of substantially all the capital stock of another corporation with which it was not previously affiliated, a full disclosure of the circumstances of such changes in ownership shall be submitted to the Commissioner. In accordance with the peculiar circumstances in each case the Commissioner may require separate or consolidated returns to be filed, to the end that the tax may be equitably assessed.

ART. 635. **Corporation deriving chief income from Government contracts.**—In the case of any affiliated corporation organized after August 1, 1914, and not a successor to a then existing business, 50 per cent or more of whose gross income consists of gains, profits, commissions, or other income derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, the net income and invested capital of such corporation shall be taken out of the consolidated net income and invested capital of the group of affiliated corporations and the corporation so segregated shall be separately assessed on the basis of its own invested capital and net income, the remainder of such affiliated group being assessed on the basis of the remaining consolidated invested capital and net income. See section 1 of the statute and article 1510.

ART. 636. **Domestic corporation affiliated with foreign corporation.**—A domestic corporation which owns a majority of the stock of a foreign corporation shall not be permitted or required to include the net income or invested capital of such foreign corporation in a consolidated return, but for the purpose of section 238 of the statute a domestic corporation which owns a majority of the voting stock of a foreign corporation shall be entitled to credit its income, war profits and excess profits taxes with any income, war profits or excess profits taxes paid (but not including taxes accrued) by such foreign corporation during the taxable year to any foreign country or to any possession of the United States upon income derived from sources without the United States in an amount equal to the proportion which the amount of any dividends (not deductible under section 234) received by such domestic corporation from such foreign corporation during the taxable year bears to the total taxable income of such foreign corporation upon or with respect to which such taxes were paid. But in no such case shall the amount of the credit for such taxes exceed the amount of such dividends (not deductible under section 234) received by such domestic corporation during the taxable year. A domestic corporation seeking such credit must comply with those provisions of subdivision (*a*) of article 383 which are applicable to credits for taxes already paid, except that in accordance with article 611 the form to be used is form 1118 instead of form 1116.

ART. 637. **Consolidated net income of affiliated corporations.**—Subject to the provisions covering the determination of taxable net income of separate corporations, and subject further to the elimination of intercompany transactions, the consolidated taxable net income shall be the combined net income of the several corporations consolidated, except that the net income of corporations coming within the provisions of article 635 shall be taken out. In respect of the statement of gross income and deductions and the several schedules required under form 1120, a corporation filing a consolidated return is required to prepare and file such statements and schedules in columnar form to the end that the details of the items of gross income and deductions for each corporation included in the consolidation may be readily audited.

ART. 638. **Different fiscal years of affiliated corporations.**—In the case of all consolidated returns, consolidated invested capital must be computed as of the beginning of the taxable year of the parent or principal reporting company and consolidated income must be computed on the basis of its taxable year. Whenever the fiscal year of one or more subsidiary or other affiliated corporations differs from the fiscal year of the parent or principal corporation, the Commissioner should be fully advised by the taxpayer in order that provision may be made for assessing the tax in respect of the period prior to the beginning of the fiscal year of the parent or principal company. See section 226 of the statute and article 431.

TIME AND PLACE FOR FILING RETURNS.

SEC. 241. (a) That returns of corporations shall be made at the same time as is provided in subdivision (a) of section 227.

(b) Returns shall be made to the collector of the district in which is located the principal place of business or principal office or agency of the corporation, or, if it has no principal place of business or principal office or agency in the United States, then to the collector at Baltimore, Maryland.

ART. 651. **Time and place for filing returns.**—Returns of income must be made on or before the fifteenth day of the third month following the close of the fiscal or calendar year, as provided in section 227 of the statute and articles 441–447. A corporation going into liquidation during any taxable year may upon the completion of such liquidation prepare a return covering its income for the fractional part of the year during which it was engaged in business and may immediately file such return with the collector. A corporation having an office or agency in the United States must make its return to the collector of the district in which is located its principal office or agency. Other corporations must make their returns to the collector at Baltimore. See also sections 250 and 253 of the statute and articles 1001–1013 and 1041.

PART II B.

WAR-PROFITS AND EXCESS-PROFITS TAX.

GENERAL DEFINITIONS.

SEC. 300. That when used in this title the terms "taxable year," "fiscal year," "personal service corporation," "paid or accrued," and "dividends" shall have the same meaning as provided for the purposes of income tax in sections 200 and 201. The first taxable year for the purposes of this title shall be the same as the first taxable year for the purposes of the income tax under Title II.

ART. 701. **War-profits and excess-profits tax.**—The war-profits and excess-profits tax, like the income tax, is a tax upon net income. See Part II A of the regulations. It applies only to corporations. See section 301 of the statute and articles 711–720. The terms "taxable year," "fiscal year," "personal service corporation," "paid or accrued," and "dividends," and in general all other terms used in connection with the income tax, have here the same meaning as provided for the purposes of the income tax. See sections 1, 200, and 201 and articles 1501–1510, 1523–1533 and 1541–1549. For other terms see sections 310 and 325 and articles 771 and 811–818.

IMPOSITION OF TAX.

SEC. 301. (a) That in lieu of the tax imposed by Title II of the Revenue Act of 1917, but in addition to the other taxes imposed by this Act, there shall be levied, collected, and paid for the taxable year 1918 upon the net income of every corporation a tax equal to the sum of the following:

FIRST BRACKET.

30 per centum of the amount of the net income in excess of the excess-profits credit (determined under section 312) and not in excess of 20 per centum of the invested capital;

SECOND BRACKET.

65 per centum of the amount of the net income in excess of 20 per centum of the invested capital;

THIRD BRACKET.

The sum, if any, by which 80 per centum of the amount of the net income in excess of the war-profits credit (determined under section 311) exceeds the amount of the tax computed under the first and second brackets.

(b) For the taxable year 1919 and each taxable year thereafter there shall be levied, collected, and paid upon the net income of every corporation (except corporations taxable under subdivision (c) of this section) a tax equal to the sum of the following:

FIRST BRACKET.

20 per centum of the amount of the net income in excess of the excess-profits credit (determined under section 312) and not in excess of 20 per centum of the invested capital;

SECOND BRACKET.

40 per centum of the amount of the net income in excess of 20 per centum of the invested capital.

(c) For the taxable year 1919 and each taxable year thereafter there shall be levied, collected, and paid upon the net income of every corporation which derives in such a year a net income of more than $10,000 from any Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, a tax equal to the sum of the following:

(1) Such a portion of a tax computed at the rates specified in subdivision (a) as the part of the net income attributable to such Government contract or contracts bears to the entire net income. In computing such tax the excess-profits credit and the war-profits credit applicable to the taxable year shall be used;

(2) Such a portion of a tax computed at the rates specified in subdivision (b) as the part of the net income not attributable to such Government contract or contracts bears to the entire net income.

For the purpose of determining the part of the net income attributable to such Government contract or contracts, the proper apportionment and allocation of the deductions with respect to gross income derived from such Government contract or contracts and from other sources, respectively, shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

(d) In any case where the full amount of the excess-profits credit is not allowed under the first bracket of subdivision (a) or (b), by reason of the fact that such credit is in excess of 20 per centum of the invested capital, the part not so allowed shall be deducted from the amount in the second bracket.

(e) For the purposes of the Act approved March 21, 1918, entitled "An Act to provide for the operation of transportation systems while under Federal control, for the just compensation of their owners, and for other purposes," the tax imposed by this title shall be treated as levied by an Act in amendment of Title II of the Revenue Act of 1917.

ART. 711. **Imposition of tax.**—The tax is imposed upon the net income of every corporation, domestic or foreign, except personal service corporations and certain other classes of corporations. See section 304 of the statute and articles 751–753. Special provisions of the statute deal with corporations deriving net income from Government contracts (see section 1), transportation corporations (see article 504), corporations partly partaking of the nature of personal service corporations (see section 303), corporations engaged in the mining of gold (see section 304), foreign and abnormal corporations (see section 327), reorganized and consolidated corporations (see sections 330 and 331), corporations making their returns upon the basis of a fiscal year (see section 335), and corporations which have sold mines or oil or gas wells (see section 337). For the requirements as to rendering returns see section 336.

ART. 712. **Computation of tax for 1918.**—For the taxable year 1918, (*a*) if the net income, as defined in section 320 (a) (3) of the statute, is not in excess of 20 per cent of the invested capital, as defined in section 326, then under the first bracket the tax is 30 per cent of the amount of the net income in excess of the excess profits credit, as defined in section 312, and the second bracket is not applicable. (*b*) If the net income is in excess of 20 per cent of the invested captal, then under the first bracket the tax is 30 per cent of the excess of an amount of net income equal to 20 per cent of the invested capital over the excess profits credit, and under the second bracket the tax is 65 per cent of the amount of the remaining net income less any excess profits credit not exhausted under the first bracket. (*c*) If the tax under (*a*) or the aggregate tax under (*b*) equals or exceeds 80 per cent of the amount of the net income in excess of the war profits credit, as defined in section 311, then the tax under (*a*) or (*b*) is the amount of the tax payable. But if such tax is less than such 80 per cent, then the tax payable is 80 per cent of the amount of the net income in excess of the war profits credit. But see section 302 and articles 731–733.

ART. 713. **Computation of tax for years after 1918.**—For the taxable year 1919 and subsequent years, (*a*) if the net income, as defined in section 320 (a) (3) of the statute, is not in excess of 20 per cent of the invested capital, as defined in section 326, then under the first bracket the tax payable is 20 per cent of the amount of the net income in excess of the excess profits credit, as defined in section 312, and the second bracket is not applicable. (*b*) If the net income is in excess of 20 per cent of the invested capital, then under the first bracket the tax is 20 per cent of the excess of an amount of net income equal to 20 per cent of the invested capital over the excess profits credit, and under the second bracket the tax is 40 per cent of the amount of the remaining net income less any excess profits credit not exhausted under the first bracket. The sum of the taxes computed under the two brackets is the tax payable. But see the following article and section 302.

ART. 714. **Computation of tax on income from Government contracts.**—In the case of a corporation which derives in any taxable year after 1918 a net income of more than $10,000 from any Government contracts made after April 5, 1917, and before November 12, 1918, the tax shall be such a proportion of a tax computed at the rates for 1918 as the portion of the net income attributable to the Government contracts bears to the entire net income, plus such a proportion of a tax computed at the rates for 1919 as the amount of the remaining net income bears to the entire net income. In computing such taxes, however, the excess profits credit and the war profits credit applicable to the taxable year shall be used. But see section 302 of the statute. The part of the net income attributable to such Government contracts shall be determined in accordance with the following article. See also section 1 and article 1510.

ART. 715. **Allocation of net income to particular source.**—Whenever it is necessary to determine the portion of the net income derived from or attributable to a particular source, the corporation shall allocate to the gross income derived from such source, and to the gross income derived from each other source, the expenses, losses, and other deductions properly appertaining thereto, and shall apply any general expenses, losses, and deductions (which can not properly be otherwise apportioned) ratably to the gross income from all sources. The gross income derived from a particular source, less the deductions properly appertaining thereto and less its proportion of any general deductions, shall be the net income derived from such source. The corporation shall submit with its return a statement fully explaining the manner in which such expenses, losses, and deductions were allocated or distributed.

ART. 716. **Illustration of computation of tax.**—

A corporation has an average prewar invested capital of $50,000, an average prewar net income of $10,000, an invested capital for 1918 of $100,000, a net income for 1918 of $40,000, an invested capital for 1919 of $110,000, and a net income of $50,000.

(1) For 1918 the excess profits credit is a specific exemption of $3,000, plus 8 per cent of the invested capital (i. e., 8 per cent of $100,000) or $8,000, making a total of $11,000. See section 312 of the statute and article 791. The war profits credit is a specific exemption of $3,000, plus the average prewar net income or $10,000, plus or minus 10 per cent of the difference between the average prewar invested capital and the invested capital for 1918. In this case it is plus, because the invested capital for 1918 is greater than the average prewar invested capital. The amount added is 10 per cent of the difference between $100,000 and $50,000, i. e., 10 per cent of $50,000, or $5,000, making a total war profits credit of $18,000. See section 311 and article 781.

First bracket.—The amount or portion of the net income ($40,000) in excess of the excess profits credit ($11,000) and not in excess of 20 per cent of the invested capital (i. e., 20 per cent of $100,000) or $20,000 is $9,000. The tax computed under this bracket is 30 per cent of this amount (i. e., 30 per cent of $9,000) or $2,700.

Second bracket.—The amount or portion of the net income ($40,000) in excess of 20 per cent of the invested capital (i. e., 20 per cent of $100,000) or $20,000 is $20,000. The tax computed under this bracket is 65 per cent of this amount (i. e., 65 per cent of $20,000) or $13,000.

Third bracket.—Eighty per cent of the amount or portion of the net income in excess of the war profits credit (i. e., 80 per cent of the amount by which $40,000 exceeds $18,000, or $22,000) is $17,600. The amount of the tax computed under the first and second brackets ($2,700 plus $13,000) is $15,700. The tax computed under this bracket is the amount by which $17,600 exceeds $15,700, or $1,900.

Total tax.—The total tax for 1918 is the sum of the taxes computed under the three brackets (i. e., $2,700 plus $13,000 plus $1,900) or $17,600.

(2) For 1919 the excess profits credit is a specific exemption of $3,000 plus 8 per cent of the invested capital (i. e., 8 per cent of $110,000) or $8,800, a total of $11,800. See section 312 and article 791.

First bracket.—The amount or portion of the net income ($50,000) in excess of the excess profits credit ($11,800) and not in excess of 20 per cent of the invested capital (i. e., 20 per cent of $110,000) or $22,000 is $10,200. The tax computed under this bracket is 20 per cent of this amount (i. e., 20 per cent of $10,200) or $2.040.

Second bracket.—The amount or portion of the net income ($50,000) in excess of 20 per cent of the invested capital (i. e., 20 per cent of $110,000) or $22.000 is $28,000. The tax computed under this bracket is 40 per cent of this amount (i. e., 40 per cent of $28.000) or $11,200.

Total tax.—The total tax for 1919 is the sum of the taxes computed under the two brackets (i. e., $2,040 plus $11,200) or $13,240.

Art. 717. Illustration of computation where no tax under third bracket.—

If the corporation used as an illustration in article 716 had an average prewar net income of $20,000 instead of $10,000, the excess profits credit and the tax for 1918 computed under the first and second brackets would be the same, but the war profits credit and the tax computed under the third bracket would not be the same. The war profits credit would be a specific exemption of $3,000 plus the average prewar net income, or $20,000, plus 10 per cent of $50,000 (the difference in invested capital) or $5,000, making a total war profits credit of $28,000.

Third bracket.—Eighty per cent of the amount of the net income in excess of the war profits credit (i. e., 80 per cent of the amount by which $40,000 exceeds $28,000 or 80 per cent of $12.000) is $9.600. The amount of the tax computed under the first and second brackets ($2,700 plus $13,000) is $15.700. There is accordingly no tax under the third bracket, as $9,600 does not exceed $15,700.

Total tax.—The total tax for 1918 is the sum of the taxes computed under the three brackets (i. e., $2,700 plus $13,000 plus nothing) or $15,700. The total tax for 1919 would, of course, be the same as in article 716.

Art. 718. Illustration of computation where excess profits credit not exhausted under first bracket.—

A corporation has an average prewar invested capital of $20,000, an average prewar net income of $7,000, and invested capital and net income for 1918 of the same amounts, respectively. The excess profits credit is a specific exemption of $3,000 plus 8 per cent of the invested capital (i. e., 8 per cent of $20,000) or $1,600, a total of $4,600. The war profits credit is a specific exemption of $3,000 plus the average prewar net income of $7,000, a total of $10,000. There is nothing further to be added or deducted in this case, as there is no difference between the average invested capital for the prewar period and the invested capital for the taxable year.

First bracket.—The excess profits credit ($4,600) exceeds 20 per cent of the invested capital (20 per cent of $20,000) or $4,000, and there is no amount taxable under this bracket.

Second bracket.—The portion of the net income ($7,000) in excess of 20 per cent of the invested capital (20 per cent of $20,000) or $4,000 is $3,000. In this case, however, the full amount of the excess profits credit could not be allowed under the first bracket, so that the $3,000 which would ordinarily be taxable under this bracket is reduced by the amount of the excess profits credit not allowed under the first bracket ($600), leaving only $2,400 taxable under this bracket. The tax computed under this bracket is 65 per cent of this amount (i. e., 65 per cent of $2,400) or $1,560.

Third bracket.—The war profits credit ($10,000) exceeds the net income ($7,000), so that there is no tax under this bracket.

Total tax.—The total tax for 1918 would be the sum of the taxes computed under the three brackets (i. e., nothing plus $1,560 plus nothing) or $4,560, were it not that section 302 provides that the maximum tax shall not in this case exceed $1,200. See articles 731–733. The total tax for 1918 is therefore $1,200.

Art. 719. Illustration of computation where net income derived from Government contract.—

If in the case of the corporation used as an illustration in article 716 the $50,000 net income for 1919 includes $20,000 of net income from Government contracts, the tax for that year would be the sum of the amounts computed under clauses (1) and (2) of section 301 (c) of the statute.

(1) Under clause (1) the excess profits credit is $11,800, the same as under clause (2). The war profits credit is a specific exemption of $3,000, plus the average prewar net income, or $10,000, plus 10 per cent of $60,000 (the difference in invested capital) or $6,000, making a total war profits credit of $19,000.

First bracket.—The amount or portion of the net income ($50,000) in excess of the excess profits credit ($11,800) and not in excess of 20 per cent of the invested capital (i. e., 20 per cent of $110,000), or $22,000, is $10,200. The tax computed under this bracket is 30 per cent of this amount (i. e., 30 per cent of $10,200) or $3,060.

Second bracket.—The amount or portion of the net income ($50,000) in excess of 20 per cent of the invested capital (i. e., 20 per cent of $110,000) or $22,000, is $28,000. The tax computed under this bracket is 65 per cent of this amount (65 per cent of $28,000) or $18,200.

Third bracket.—Eighty per cent of the amount of the net income in excess of the war profits credit (i. e., 80 per cent of the amount by which $50,000 exceeds $19,000, or $31,000) is $24,800. The amount of the tax computed under the first and second brackets ($3,060 plus $18,200) is $21,260. The tax computed under this bracket is the amount by which $24,800 exceeds $21,260, or $3,540.

The portion of the tax computed under clause (1) is the same proportion of the total amount computed under the above brackets at the rates for 1918 (i. e., $3,060 plus $18,200 plus $3,540) or $24,800, as the part of the net income attributable to Government contracts ($20,000) is of the entire net income ($50,000). This portion of the tax is therefore 2/5 of $24,800, or $9,920.

(2) The portion of the tax computed under clause (2) is the same proportion of the total amount computed at the rates for 1919 or $13,240 (for the details see illustration for 1919 under article 716) as the part of the net income not attributable to Government contracts ($30,000) is of the entire net income ($50,000). This portion of the tax is therefore 3/5 of $13,240 or $7,944.

(3) The total tax for the year 1919 is the sum of the amounts computed under paragraphs (1) and (2) above ($9,920 plus $7,944) or $17,864.

Art. 720. Illustration of computation where return for period of less than 12 months.—

A corporation which has reported on the basis of the fiscal year ending March 31, 1918, later changes to a calendar year basis and files a return covering the 9 months from April 1, 1918, to December 31, 1918. It had an average prewar capital of $50,000, an average prewar net income of $3,500, an invested capital for the 9 months ending December 31, 1918, of $120,000, and a net income for such period of $50,000. It should be noted that this is a somewhat different method of arriving at the same result which would be reached under a literal application of sections 305, 311 (a) (2) and 326 (d) of the statute. The excess profits credit is computed by adding the specific exemption of $3,000 to 8 per cent of the full invested capital of $120,000, or $9,600, a total of $12,600, and taking 9/12 of this result, or $9,450, as the excess profits credit. The war profits credit is computed by adding the specific exemption of $3,000 to 10 per cent of the full invested capital of $120,000, or $12,000, a total of $15,000, and taking 9/12 of this result, or $11,250, as the war profits credit. The war profits credit is computed in this case under section 311 (b), because the amount computed under section 311 (a) (2) is less than 10 per cent of the invested capital. The amount computed under section 311 (a) (2) would be the sum of the average prewar net income, or $3,500, plus 10 per cent of the amount by which the full invested capital of $120,000 actually used during the taxable period exceeds the average prewar invested capital of $50,000 (i. e., 10 per cent of $70,000), or $7,000, a total of $10,500. This amount is less than 10 per cent of the full invested capital for the taxable year as computed under section 311 (b).

First bracket.—The amount or portion of the net income ($50,000) in excess of the excess-profits credit ($9,450) and not in excess of 9/12 of 20 per cent of the invested capital (i. e., 9/12 of 20 per cent of $120,000), or $18.000, is $8,550. The tax computed under this bracket is 30 per cent of this amount (i. e., 30 per cent of $8,550), or $2,565.

Second bracket.—The amount or portion of the net income ($50,000) in excess of 9/12 of 20 per cent of the invested capital (i. e., 9/12 of 20 per cent of $120,000), or $18,000, is $32,000. The tax computed under this bracket is 65 per cent of this amount (i. e., 65 per cent of $32,000), or $20,800.

Third bracket.—80 per cent of the amount or portion of the net income in excess of the war-profits credit (i. e., 80 per cent of the amount by which $50,000 exceeds $11,250, or $38,750), is $31,000. The amount of the tax computed under the first and second brackets ($2,565 plus $20,800) is $23,365. The tax computed under this bracket is the amount by which $31,000 exceeds $23,365, or $7,635.

Total tax.—The total tax will be the sum of the taxes computed under the three brackets (i. e., $2,565 plus $20,800 plus $7,635) or $31,000.

LIMITATION OF TAX.

Sec. 302. That the tax imposed by subdivision (a) of section 301 shall in no case be more than 30 per centum of the amount of the net income in excess of $3,000 and not in excess of $20,000, plus 80 per centum of the amount of the net income in excess of $20,000; the tax imposed by subdivision (b) of section 301 shall in no case be more than 20 per centum of the amount of the net income in excess of $3,000 and not in excess of $20,000, plus 40 per centum of the amount of the net income in excess of $20,000; and the above limitations shall apply to the taxes computed under subdivisions (a) and (b) of section 301, respectively, when used in subdivision (c) of that section. Nothing in this section shall be construed in such manner as to increase the tax imposed by section 301.

ART. 731. **Short form of computation of limitation.**—In any case where the net income is at least $20,000 the computation under section 302 of the statute may be shortened as follows:

(1) The tax imposed by subdivision (a) of section 301 shall not exceed $5,100, plus 80 per cent of the amount of the net income in excess of $20,000; and

(2) The tax imposed by subdivision (b) of section 301 shall not exceed $3,400, plus 40 per cent of the amount of the net income in excess of $20,000.

Where the net income is less than $20,000 the tax shall not exceed 30 per cent or 20 per cent, as the case may be, of the amount of the net income in excess of $3,000.

ART. 732. **Limitation when return for fractional part of year.**—When a return is rendered for a fractional part of a year the limitation shall be computed by taking that proportion of $3,000 and of $20,000, respectively, which the period covered by the return bears to a full year. The rates of tax, however, will not be affected and should be applied as in the ordinary case.

ART. 733. **Illustration of computation of limitation of tax.**—

If in the illustration used in article 720 the invested capital had been $100,000 and the net income $80,000, the tax computed under section 301 (a) of the statute would be $56,200. Section 302 provides, however, that the tax under section 301 (a) shall not be more than 30 per cent of the net income in excess of $3,000 and not in excess of $20,000 plus 80 per cent of the net income in excess of $20,000. In this case the return is for three-fourths of a year and the $3,000 and $20,000 are reduced to $2,250 and $15,000, respectively. The tax is therefore 30 per cent of $12,750 (the difference between $2,250 and $15,000), plus 80 per cent of $65,000 (the balance of the net income), a total of $55,825. The tax under section 301 (a), amounting to $56,200, will accordingly be reduced to $55,825.

TAX WHEN PARTLY PERSONAL SERVICE BUSINESS.

SEC. 303. That if part of the net income of a corporation is derived (1) from a trade or business (or a branch of a trade or business) in which the employment of capital is necessary, and (2) a part (constituting not less than 30 per centum of its total net income) is derived from a separate trade or business (or a distinctly separate branch of the trade or business) which if constituting the sole trade or business would bring it within the class of "personal service corporations," then (under regulations prescribed by the Commissioner with the approval of the Secretary) the tax upon the first part of such net income shall be separately computed (allowing in such computation only the same proportionate part of the credits authorized in sections

311 and 312), and the tax upon the second part shall be the same percentage thereof as the tax so computed upon the first part is of such first part: *Provided*, That the tax upon such second part shall in no case be less than 20 per centum thereof, unless the tax upon the entire net income, if computed without benefit of this section, would constitute less than 20 per centum of such entire net income, in which event the tax shall be determined upon the entire net income, without reference to this section, as other taxes are determined under this title. The total tax computed under this section shall be subject to the limitations provided in section 302.

ART. 741. **Apportionment of invested capital and net income.**—For the purpose of determining whether or not a corporation partly partaking of the nature of a personal service corporation is within the scope of section 303 of the statute and also for the purpose of establishing the basis for the computation of the tax, the corporation shall apportion or allocate its invested capital between each trade or business or branch thereof as nearly as may be in accordance with the actual facts, and shall submit with its return an explanatory statement setting forth the manner in which the apportionment of the invested capital employed in the production of each part of its net income has been determined. There must be assigned to any personal service trade or business or branch thereof an amount of invested capital at least as great as that which would ordinarily be employed by a personal service corporation of similar size and standing for the payment of salaries and office expenses, maintenance of library and equipment, credit advances to clients, etc. For the method of determining the portion of the net income derived from each trade or business or branch thereof see article 715. For the definition of "personal service corporation" see articles 1523–1532.

ART. 742. **Computation of tax upon net income.**—(1) The tax upon the non-personal service part of the net income is computed upon the basis of (*a*) such part of the entire average net income for the prewar period as was derived from the same trade or business or branch thereof; (*b*) such part of the entire average invested capital for the prewar period as was employed in the production of the part of the net income for that period determined under (*a*); (*c*) such part of the entire invested capital for the taxable year as has been employed in the production of the net income upon which the tax is being computed; and (*d*) the same proportion of the specific exemption as the proportion which the part of the net income upon which the tax is being computed is of the entire net income. If the corporation was in existence during the prewar period, but did not conduct this trade or business or branch thereof during that period, the war profits credit shall be computed as provided in section 311 (b) of the statute.

(2) The tax upon the personal service part of the net income is the same percentage thereof as the tax computed under (1) is of the non-

personal service part of the net income. The tax under this paragraph shall in no case be less than 20 per cent of the personal service part of the entire net income, unless the tax upon the entire net income if computed in the ordinary way would be less than 20 per cent of such entire net income. In that event, and in any case in which the amount of the total tax as computed under this article is the same as or greater than the tax as computed in the ordinary way, the tax shall be computed under section 301 of the statute. See section 302 and articles 711–720 and 731–733.

ART. 743. **Illustration of computation of tax where partly personal service business.—**

A corporation is engaged in contracting and construction work (a non-personal service business in which the employment of capital is necessary) and also renders consulting engineering service (a personal service business which if constituting its sole business would bring it within the class of personal service corporations). It has an average prewar invested capital of $50,000 (of which $38,000 was used in contracting work and $12,000 in engineering); an average prewar net income of $52,000 (of which $12,000 was derived from contracting and $40,000 from engineering); an invested capital for 1918 of $100,000 (of which $81,000 is used in contracting and $19,000 in engineering); and a net income for 1918 of $90,000 (of which $30,000 is derived from contracting and $60,000 from engineering).

(1) In computing the tax upon the first or nonpersonal service part of the net income (i. e., $30,000 derived from contracting) the specific exemption is $1,000 (i. e., the same proportion of $3,000 which $30,000 is of the entire net income of $90,000). The excess profits credit is a specific exemption of $1,000, plus 8 per cent of the invested capital used in contracting (i. e., 8 per cent of $81,000) or $6,480, a total of $7,480. The war profits credit is a specific exemption of $1,000, plus the average prewar net income derived from contracting or $12,000, plus 10 per cent of $43,000 (the difference in invested capital used in contracting) or $4,300, making a total of $17,300.

First bracket.—The amount of the net income derived from contracting ($30,000) in excess of the excess profits credit ($7,480) and not in excess of 20 per cent of the invested capital (i. e., 20 per cent of $81,000) or $16,200 is $8,720. The tax under this bracket is 30 per cent of this amount (i. e., 30 per cent of $8,720) or $2,616.

Second bracket.—The amount of the net income derived from contracting ($30,000) in excess of 20 per cent of the invested capital used in contracting (i. e., 20 per cent of $81,000) or $16,200 is $13,800. The tax computed under this bracket is 65 per cent of this amount (65 per cent of $13,800) or $8,970.

Third bracket.—Eighty per cent of the amount of the net income derived from contracting in excess of the war profits credit (i. e., 80 per cent of the amount by which $30,000 exceeds $17,300 or 80 per cent of $12,700) is $10,160. The amount of the tax computed under the first and second brackets ($2,616 plus $8,970) is $11,586. There is no tax under this bracket, as $10,160 does not exceed $11,586.

Tax.—The tax upon the first portion of the net income (i. e., $30,000 derived from contracting) is the sum of the taxes computed under the three brackets (i. e., $2,616 plus $8,970 plus nothing) or $11,586. This is 38.62 per cent of $30,000 of the net income from contracting.

(2) The tax upon the second or personal service part of the net income (i. e., $60,000 derived from engineering) is the same percentage of such part of the net income (i. e., 38.62 per cent of $60,000) or $23,172.

(3) The total tax is the sum of $11,586 (the tax upon the first part of the net income derived from contracting) and $23,172 (the tax upon the second part of the net income derived from engineering) or $34,758.

EXEMPTIONS.

SEC. 304. (a) That the corporations enumerated in section 231 shall, to the extent that they are exempt from income tax under Title II, be exempt from taxation under this title.

(b) Any corporation whose net income for the taxable year is less than $3,000 shall be exempt from taxation under this title.

(c) In the case of any corporation engaged in the mining of gold, the portion of the net income derived from the mining of gold shall be exempt from the tax imposed by this title, and the tax on the remaining portion of the net income shall be the proportion of a tax computed without the benefit of this subdivision which such remaining portion of the net income bears to the entire net income.

ART. 751. **Corporations exempt from tax.**—A corporation whose net income for a full taxable year of twelve months is less than $3,000 is exempt from the tax. If the taxable period is less than twelve months the corporation is exempt from the tax if its net income for the period is less than the same proportion of $3,000 as the number of months in the period is of twelve months, any fractional part of a month being counted as the number of days in such part of a month divided by 30. Certain classes of corporations, including personal service corporations, named in section 231 of the statute are also exempt. See articles 511–522.

ART. 752. **Net income exempt from tax.**—If a corporation is engaged in the mining of gold, the portion of its net income derived from that source is exempt from tax. The tax on the remaining portion of its net income is the proportion of the tax that would have been payable, had the entire net income been derived from other sources than the mining of gold, which such remaining portion of the net income bears to the entire net income. For the method of determining the net income derived from the mining of gold see article 715.

ART. 753. **Illustration of computation of tax where net income from gold mining.**—

In the case of the corporation used as an illustration in article 716 let it be assumed that it is engaged in the mining both of gold and of other rare metals; that the Commissioner finds under article 715 that $35,000 of its gross income is properly attributable to the mining of gold; and that $20,000 of the deductions allowed are properly applicable to the gross income from that source. The portion of the net income attributable to the mining of gold and exempt from tax would be $15,000. The remaining portion of the net income is $25,000 and the tax thereon is the same proportion of the tax computed on the entire net income without the benefit of the exemption (i. e., a tax of $17,600) which the remaining portion of the net income ($25,000) bears to the entire net income ($40,000). The tax will therefore be 5/8 of the tax of $17,600 computed without the benefit of the exemption, or $11,000.

APPORTIONMENT OF SPECIFIC EXEMPTION.

SEC. 305. That if a tax is computed under this title for a period of less than twelve months, the specific exemption of $3,000, wherever referred to in this title, shall be reduced to an amount which is the same proportion of $3,000 as the number of months in the period is of twelve months.

ART. 761. **Apportionment of specific exemption.**—The specific exemption of $3,000 is apportioned only in the case where a return is made covering a period of less than twelve months. In such a case the specific exemption is the same proportion of $3,000 as the number of months in the period is of twelve months, any fractional part of a month being counted as the number of days in such part of a month divided by 30. Thus, in the case of a corporation organized May 12, 1918, and making a return for the period ending December 31, 1918, the exemption is $1,916.67, that is, the same proportion of $3,000 as $7\frac{20}{30}$ months is of 12 months. This provision is inapplicable where the return is made for a full fiscal year beginning prior to January 1, 1918, and ending after that date, even though the income for such fiscal year is not subject to full taxation under the present statute.

PREWAR PERIOD.

SEC. 310. That as used in this title the term "prewar period" means the calendar years 1911, 1912, and 1913, or, if a corporation was not in existence during the whole of such period, then as many of such years during the whole of which the corporation was in existence.

ART. 771. **Prewar period.**—The prewar period in the case of each corporation covers so many of the calendar years 1911, 1912, and 1913 during the whole of which it, or a predecessor trade or business, was in existence. See section 330 of the statute and articles 931–934. If a new enterprise was launched in corporate form in June, 1912, its prewar period would accordingly be the calendar year 1913. The prewar period when mentioned without reference to any particular corporation means the calendar years 1911, 1912, and 1913.

WAR PROFITS CREDIT.

SEC. 311. (a) That the war-profits credit shall consist of the sum of:

(1) A specific exemption of $3,000; and

(2) An amount equal to the average net income of the corporation for the prewar period, plus or minus, as the case may be, 10 per centum of the difference between the average invested capital for the prewar period and the invested capital for the taxable year. If the tax is computed for a period of less than twelve months such amount shall be

reduced to the same proportion thereof as the number of months in the period is of twelve months.

(b) If the corporation had no net income for the prewar period, or if the amount computed under paragraph (2) of subdivision (a) is less than 10 per centum of its invested capital for the taxable year, then the war-profits credit shall be the sum of:

(1) A specific exemption of $3,000; and

(2) An amount equal to 10 per centum of the invested capital for the taxable year.

(c) If the corporation was not in existence during the whole of at least one calendar year during the prewar period, then, except as provided in subdivision (d), the war-profits credit shall be the sum of:

(1) A specific exemption of $3,000; and

(2) An amount equal to the same percentage of the invested capital of the taxpayer for the taxable year as the average percentage of net income to invested capital, for the prewar period, of corporations engaged in a trade or business of the same general class as that conducted by the taxpayer; but such amount shall in no case be less than 10 per centum of the invested capital of the taxpayer for the taxable year. Such average percentage shall be determined by the Commissioner on the basis of data contained in returns made under Title II of the Revenue Act of 1917, and the average known as the median shall be used. If such average percentage has not been determined and published at least 30 days prior to the time when the return of the taxpayer is due, then for purposes of such return 10 per centum shall be used in lieu thereof; but such average percentage when determined shall be used for the purposes of section 250 in determining the correct amount of the tax.

(d) The war-profits credit shall be determined in the manner provided in subdivision (b) instead of in the manner provided in subdivision (c), in the case of any corporation which was not in existence during the whole of at least one calendar year during the prewar period, if (1) a majority of its stock at any time during the taxable year is owned or controlled, directly or indirectly, by a corporation which was in existence during the whole of at least one calendar year during the prewar period, or if (2) 50 per centum or more of its gross income (as computed under section 233 for income tax purposes) consists of gains, profits, commissions, or other income, derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

(e) A foreign corporation shall not be entitled to a specific exemption of $3,000.

ART. 781. **War profits credit.**—Ordinarily the war profits credit consists of the sum of the specific exemption of $3,000 and an amount equal to the average net income of the corporation for the prewar period, plus 10 per cent of the excess of the invested capital for the taxable year over the average invested capital for the prewar period, or minus 10 per cent of the excess of the average invested capital for the prewar period over the invested capital for the taxable year. If a return is made for a period of less than twelve months, the amount equal to the average net income for the prewar period plus or minus 10 per cent of the difference between the average invested capital for the prewar period and the invested capital for the taxable year shall be reduced to the same proportion thereof as the number of months in the period is of twelve months. See section 305 of the statute and article 761. If at the time a return is made the net income for the prewar period or the difference between the average invested capital for the prewar period and the invested capital for the taxable year can not be determined, the war profits credit shall be computed in the first instance as provided in the following article. If either of these amounts can not eventually be determined, the war profits credit shall be finally determined as provided in the following article. See also section 327 and articles 716–720, 743, and 901.

ART. 782. **War profits credit where meager prewar net income.**—If a corporation had no net income for the prewar period, or if the war profits credit as ordinarily computed (exclusive of the specific exemption of $3,000) is less than 10 per cent of its invested capital for the taxable year, then the war profits credit consists of the sum of the specific exemption of $3,000 and an amount equal to 10 per cent of the corporation's invested capital for the taxable year. See article 720.

ART. 783. **War profits credit where no prewar period.**—If a corporation had no prewar period, then the war profits credit consists of the sum of the specific exemption of $3,000 and an amount equal to the same percentage of the invested capital for the taxable year as the average percentage of net income to invested capital for the prewar period of corporations engaged in a trade or business of the same general class as that conducted by the taxpayer, but not less than 10 per cent of its invested capital for the taxable year. The war profits credit shall be computed in the first instance on the basis of 10 per cent of the invested capital, and when the average percentage of corporations engaged in the same general class of trade or business has been determined the amount of the tax will if necessary be recomputed. See section 250 of the statute and articles 784 and 1001.

ART. 784. **War profits credit where no prewar period in special circumstances.**—If a corporation had no prewar period, but (*a*) if a majority of its stock at any time during the taxable year was owned or controlled by a corporation which was in existence during the whole of at least one calendar year during the prewar period, or (*b*) if 50 per cent or more of its gross income consisted of income derived from Government contracts made after April 5, 1917, and before November 12, 1918, then the war profits credit is to be determined as provided in article 782 instead of in the manner provided in article 783. See section 1 of the statute and article 1510.

ART. 785. **War profits credit in the case of affiliated corporations.**—In the case of affiliated corporations making a consolidated return only one specific exemption of $3,000 is allowed. See also sections 240 and 305 of the statute and article 761.

EXCESS PROFITS CREDIT.

SEC. 312. That the excess-profits credit shall consist of a specific exemption of $3,000 plus an amount equal to 8 per centum of the invested capital for the taxable year.

A foreign corporation shall not be entitled to the specific exemption of $3,000.

ART. 791. **Excess profits credit.**—The excess profits credit consists of the specific exemption of $3,000 plus an amount equal to 8 per cent of the invested capital for the taxable year. In the case of affiliated corporations making a consolidated return only one specific exemption of $3,000 is allowed. See also sections 240 and 305 of the statute and articles 716–720, 743, and 761.

NET INCOME.

SEC. 320. (a) That for the purpose of this title the net income of a corporation shall be ascertained and returned—

(1) For the calendar years 1911 and 1912 upon the same basis and in the same manner as provided in section 38 of the Act entitled "An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," approved August 5, 1909, except that taxes imposed by such section and paid by the corporation within the year shall be included;

(2) For the calendar year 1913 upon the same basis and in the same manner as provided in Section II of the Act entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," approved October 3, 1913, except that taxes imposed by section 38 of such Act of August 5, 1909, and paid by the corporation within the year shall be included, and except that the amounts received by it as dividends upon the stock or from the net earnings of other corporations subject to the tax imposed by Section II of such Act of October 3, 1913, shall be deducted; and

(3) For the taxable year upon the same basis and in the same manner as provided for income tax purposes in Title II of this Act.

(*b*) The average net income for the prewar period shall be determined by dividing the number of years within that period during the whole of which the corporation was in existence into the sum of the net income for such years, even though there may have been no net income for one or more of such years.

ART. 801. **Net income.**—The net income of a corporation for the purpose of the imposition of the war profits and excess profits tax is the same net income as determined for the purpose of the income tax. See section 232 of the statute and article 531. For the prewar period, however, the net income of a corporation is to be ascertained in the case of the calendar years 1911 and 1912 as provided in section 38 of the Act of August 5, 1909, and in the case of the calendar year 1913 as provided in Section II of the Act of October 3, 1913, except that in either case the amount of any taxes imposed by section 38 of the Act of August 5, 1909, and paid within the year in question should be included and that in the case of the calendar year 1913 any dividends received from other corporations taxed under Section II of the Act of October 3, 1913, should be deducted.

ART. 802. **Prewar net income of affiliated corporations.**—The consolidated net income of affiliated corporations for the prewar period shall be the average consolidated net income for the prewar years of such of the several corporations included in the consolidation for the taxable year as were affiliated during the prewar period, plus the aggregate of the average net income for each of the corporations not affiliated during the prewar period which were in existence during all of the prewar period or during at least one full year within the prewar period. The net income of a subsidiary corporation organized during the prewar period by an existing corporation shall also be included. See also sections 240 and 330 of the statute and articles 631–638 and 931–934.

TERMS RELATING TO INVESTED CAPITAL.

SEC. 325. (a) That as used in this title—

The term "intangible property" means patents, copyrights, secret processes and formulæ, good will, trade-marks, trade-brands, franchises, and other like property;

The term "tangible property" means stocks, bonds, notes, and other evidences of indebtedness, bills and accounts receivable, leaseholds, and other property other than intangible property;

The term "borrowed capital" means money or other property borrowed, whether represented by bonds, notes, open accounts, or otherwise;

The term "inadmissible assets" means stocks, bonds, and other obligations (other than obligations of the United States), the dividends or interest from which is not included in computing net income, but where the income derived from such assets consists in part of gain or profit derived from the sale or other disposition thereof, or where all or part of the interest derived from such assets is in effect included in the net income because of the limitation on the deduction of interest under paragraph (2) of subdivision (a) of section 234, a corresponding part of the capital invested in such assets shall not be deemed to be inadmissible assets;

The term "admissible assets" means all assets other than inadmissible assets, valued in accordance with the provisions of subdivision (a) of section 326, section 330, and section 331.

(b) For the purposes of this title, the par value of stock or shares shall, in the case of stock or shares issued at a nominal value or having no par value, be deemed to be the fair market value as of the date or dates of issue of such stock or shares.

ART. 811. **Intangible and tangible property.**—Intangible property includes patents and good will and other like property. Tangible property includes all property other than intangible property. Most contracts are intangible property and in the absence of a specific ruling by the Commissioner to the contrary should be so regarded for the purpose of making returns. A contract may be treated as tangible property only after the submission of a full statement as to its exact nature, showing to the satisfaction of the Commissioner that it relates to rights in tangible property to such an extent that its value arises chiefly therefrom. Associated Press, United Press, and similar franchises, and subscription lists and mailing lists, are intangible property.

ART. 812. **Borrowed capital: securities.**—Any interest in a corporation represented by bonds, debentures, or other securities, by whatever name called, including so-called preferred stock, if with respect to the payment of either interest or principal it ranks with or prior to the interest of the general creditors, is borrowed capital and cannot be included in computing invested capital. Any such preferred stock may, however, be so included if it is deferred with respect to the payment of both interest and principal to the interest of the general creditors.

ART. 813. **Borrowed capital: amounts left in business.**—Whether a given amount paid into or left in the business of a corporation constitutes borrowed capital or paid-in surplus is largely a question of fact. Thus, indebtedness to stockholders actually cancelled and left in the business would ordinarily constitute paid-in surplus, while amounts left in the business representing salaries of officers in excess of their actual withdrawals, or deposit accounts in favor of partners in a partnership succeeded by the corporation, will be considered paid-in surplus or borrowed capital according to the facts of the particular case. The general principle is that if interest is paid or is to be paid on any such amount, or if the stockholder's or officer's right to repayment of such amount ranks with or before that of the general creditors, the amount sc left with the corporation must be considered as borrowed capital and be so treated in computing invested capital.

ART. 814. **Borrowed capital: other illustrations.**—Items such as deposits or amounts due to other banks shown in the balance sheet of a bank, unexpired subscriptions shown in the balance sheet of a publishing concern, etc., are deemed liabilities and can not be included in computing invested capital.

ART. 815. **Inadmissible assets.**—Stocks, bonds, and other obligations (other than obligations of the United States), the dividends or interest from which are not required to be included in computing net income are inadmissible assets even though no such dividends or interest have been actually paid or received during the taxable year. The failure to pay or to receive dividends or interest does not change the status of such securities as inadmissible assets. A corporation can not by including the income from inadmissible assets as taxable income create the right to have such assets considered admissible assets.

ART. 816. **Inadmissible assets: Government bonds.**—Obligations of a State or Territory or any municipal or other political subdivision thereof, of the District of Columbia, or of any possession of the United States, and Federal farm loan bonds, not being obligations of the United States within the meaning of the statute, are inadmissible assets. See section 213 (b) of the statute and articles 74–82.

ART. 817. **Inadmissible assets: partial exception.**—(*a*) Where the income derived from inadmissible assets consists in part of profit from the disposition thereof, or (*b*) where all or a part of the interest derived from such assets is in effect included in net income because the interest paid on indebtedness incurred or continued to purchase or carry such assets may not be deducted from gross income, in either case a corresponding part of the capital invested in such assets shall be deemed an admissible asset. This article applies separately to each issue or class of inadmissible securities held by a corporation. For example, it may hold A company stock costing $100,000 and B company stock costing $200,000. During the year it receives $8,000 in dividends from A company and $5,000 from B company, and on September 30 sells part of its B company stock at a profit of $3,000. For the period from January 1 to September 30, $75,000 of its holdings of B company stock become admissible. After September 30 its remaining holdings of B company stock are inadmissible, but the proceeds of the sale are admissible unless invested in inadmissibles. See articles 852 and 854.

ART. 818. **Admissible assets.**—Admissible assets include all assets other than inadmissible assets. Organization expenses and deferred charges against future income are admissible assets. For all purposes of computing invested capital admissible assets must be valued in accordance with the provisions of sections 326, 330, and 331 of the statute and the articles thereunder. Thus, for example, intangible property paid in for stock or shares is an admissible asset, but it can not be valued at an amount in excess of that at which it may be included in computing invested capital under paragraphs (4) and (5) of section 326 (a).

INVESTED CAPITAL.

SEC. 326. (a) That as used in this title the term "invested capital" for any year means (except as provided in subdivisions (b), and (c) of this section):

(1) Actual cash bona fide paid in for stock or shares;

(2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, but in no

case to exceed the par value of the original stock or shares specifically issued therefor, unless the actual cash value of such tangible property at the time paid in is shown to the satisfaction of the Commissioner to have been clearly and substantially in excess of such par value, in which case such excess shall be treated as paid-in surplus: *Provided*, That the Commissioner shall keep a record of all cases in which tangible property is included in invested capital at a value in excess of the stock or shares issued therefor, containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, the value of the tangible property at the time paid in, the par value of the stock or shares specifically issued therefor, and the amount included under this paragraph as paid-in surplus. The Commissioner shall furnish a copy of such record and other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257;

(3) Paid-in or earned surplus and undivided profits; not including surplus and undivided profits earned during the year;

(4) Intangible property bona fide paid in for stock or shares prior to March 3, 1917, in an amount not exceeding (a) the actual cash value of such property at the time paid in, (b) the par value of the stock or shares issued therefor, or (c) in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding on March 3, 1917, whichever is lowest;

(5) Intangible property bona fide paid in for stock or shares on or after March 3, 1917, in an amount not exceeding (a) the actual cash value of such property at the time paid in, (b) the par value of the stock or shares issued therefor, or (c) in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding at the beginning of the taxable year, whichever is lowest: *Provided*, That in no case shall the total amount included under paragraphs (4) and (5) exceed in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding at the beginning of the taxable year; but
a percentage thereof equal to the percentage which the amount of include borrowed capital.

(c) There shall be deducted from invested capital as above defined a percentage thereof equal to the percentage which the amount of inadmissible assets is of the amount of admissible and inadmissible assets held during the taxable year.

(d) The invested capital for any period shall be the average invested capital for such period, but in the case of a corporation making a return for a fractional part of a year, it shall (except for the purpose of paragraph (2) of subdivision (a) of section 311) be the same fractional part of such average invested capital.

The average invested capital for the prewar period shall be determined by dividing the number of years within that period during the whole of which the corporation was in existence into the sum of the average invested capital for such years.

Art. 831. **Meaning of invested capital.**—Invested capital within the meaning of the statute is the capital actually paid in to the corporation by the stockholders, including the surplus and undivided profits, and is not based upon the present net worth of the assets, as shown by an appraisal or in any other manner. The basis or starting point in the computation of invested capital is found in the amount of cash and other property paid in, the valuation at which such other property may be included being determined in accordance with the statute and the regulations. The computation does not stop, however, with such original entries or amounts, but also takes into account the surplus and undivided profits of prior years left in the business. The invested capital of a corporation includes, generally speaking, (*a*) the cash paid in for stock, (*b*) the tangible property paid in for stock, (*c*) the surplus and undivided profits, and (*d*) the intangible property paid in for stock (to a limited amount), less, however, the same proportion of such aggregate sum as the amount of inadmissible assets bears to the amount of the admissible assets and the inadmissible assets held during the taxable year. Invested capital does not include borrowed capital. See section 325 of the statute and articles 811–818. The fair market value of the assets as of March 1, 1913, has no bearing on invested capital. See section 202 and article 1561.

ART. 832. **Cash paid in: bonus stock.**—Capital stock issued as a bonus in connection with the sale of a corporation's bonds may not be included in invested capital unless the corporation proves to the satisfaction of the Commissioner that such stock bonus enabled the corporation to secure a higher price for the bonds than it could otherwise have secured. Wherever this fact is established such stock shall be included in computing invested capital to the extent of the difference between the selling price of the bonds and the price at which they could have been sold if issued without such stock bonus. The excess of the face value of such bonds over the price at which they could have been sold if issued without the stock bonus is deemed discount and is subject to amortization. See article 39.

ART. 833. **Tangible property paid in: evidences of indebtedness.**—Enforcible notes or other evidences of indebtedness, either interest-bearing or noninterest bearing, of the subscriber received by a corporation upon a subscription for stock may be considered as tangible property in computing its invested capital to the extent of the actual cash value of such notes or other evidences of indebtedness at the time when paid in, but only (*a*) if such notes or evidences of indebtedness could under the laws of the jurisdiction in which the corporation was organized legally be received in payment for stock, and (*b*) if they were actually received by the corporation as absolute, and not as conditional, payment in whole or in part of the stock subscription.

ART. 834. **Tangible property paid in: inadmissible assets.**—Stocks, bonds, and other obligations (other than obligations of the United

States), the dividends or interest from which are not included in computing net income, when bona fide paid in for stock or shares may like other tangible property be included in computing the invested capital of the corporation at their actual cash value when paid in. For the purpose of the reduction required in articles 852 and 854, however, account must be taken of such assets in the same manner as of any other inadmissible assets.

ART. 835. **Tangible property paid in: mixture of tangible and intangible property.**—Where stock or shares and bonds or other obligations have been issued for a mixed aggregate of tangible and intangible property, it will be presumed in the absence of satisfactory evidence to the contrary that the bonds were issued for tangible property and that the stock was issued for the balance of the tangible property, if any, and for the intangible property. Where stock or shares have been issued for a mixed aggregate of tangible and intangible property and certain liabilities have been assumed in connection with the transaction, it will be presumed that such liabilities are to be charged against the tangible property and the intangible property in the order named, unless it is shown by evidence satisfactory to the Commissioner that this presumption is not in accordance with the facts. See further section 327 (c) of the statute.

ART. 836. **Tangible property paid in: value in excess of par value of stock.**—Evidence offered to support a claim for a paid-in surplus must be as of the date of the payment, and may consist among other things of (*a*) an appraisal of the property by disinterested authorities made on or about the date of the transaction; (*b*) certification of the assessed value in the case of real estate; and (*c*) proof of a market price in excess of the par value of the stock or shares. The additional value allowed in any case is confined to the value definitely known or accurately ascertainable at the time of the payment. No claim will be allowed for a paid-in surplus in a case in which the additional value has been developed or ascertained subsequently to the date on which the property was paid in to the corporation, or in respect of property which the stockholders or their agents on or shortly before the date of such payment acquired at a bargain price, as for instance, at a receiver's sale. Generally, allowable claims under this article will arise out of transactions in which there has been no substantial change of beneficial interest in the property paid in to the corporation, and in all cases the proof of value must be clear and explicit.

ART. 837. **Surplus and undivided profits: paid-in surplus.**—Where it is shown by evidence satisfactory to the Commissioner that tangible property has been paid in by a stockholder to a corporation as a gift or at a value definitely known or accurately ascertainable as of the date of such payment clearly and substantially in excess of the cash or other consideration paid by the corporation therefor, then the amount of the excess shall be deemed to be paid-in surplus. Substantially the same kind of evidence will be required under this article as under article 836. See further article 813.

ART. 838. **Surplus and undivided profits: earned surplus.**—Only true earned surplus and undivided profits can be included in the computation of invested capital, and if for any reason the books do not properly reflect the true surplus such adjustments must be made as are necessary in order to arrive at the correct amount. In the computation of earned surplus and undivided profits full recognition must first be given to all expenses incurred and losses sustained from the original organization of the corporation down to the taxable year, including among such expenses and losses reasonable allowances for depreciation, obsolescence, or depletion of property (irrespective of the manner in which such property was originally acquired), and for the amortization of any discount on its bonds. There can, of course, be no earned surplus or undivided profits until any deficit or impairment of paid-in capital due to depletion, depreciation, expense, losses, or any other cause has been made good. Where adequate evidence is presented that the amounts written off or deducted in previous returns of net income are in the aggregate incorrect or unreasonable, adjustments must be made, and, if not barred by the statute of limitations, the taxpayer will be allowed a refund in respect of any taxes overpaid in prior years, or in the case of an underpayment of taxes will be additionally assessed.

ART. 839. **Surplus and undivided profits: allowance for depletion and depreciation.**—Depletion, like depreciation, must be recognized in all cases in which it occurs. Depletion attaches to each unit of mineral or other property removed, and the denial of a deduction in computing net income under the Act of August 5, 1909, or the limitation upon the amount of the deduction allowed under the Act of October 3, 1913, does not relieve the corporation of its obligation to make proper provision for depletion of its property in computing its surplus and undivided profits. Adjustments in respect of depreciation or depletion in prior years will be made or permitted only upon the basis of affirmative evidence that as at the beginning of the taxable year the amount of depreciation or depletion written off in prior years was insufficient or excessive, as the case may be. Where deductions for depreciation or depletion have either on the books of the corporation or in its returns of net income been included in the past in expense or other accounts, rather than specifically as depreciation or depletion, or where capital expenditures have been charged to expense in lieu of depreciation or depletion, a statement indicating the extent to which this practice has been carried should accompany the return.

Art. 840. Surplus and undivided profits: additions to surplus account.—A corporation's books of account will be presumed to show the facts. If it claims that its capital or surplus account is understated the burden of proof will rest upon it. Additions to such accounts will be accepted to the following extent:

(1) Excessive depreciation heretofore charged off on property still owned and in use, if it is now shown by satisfactory proof to have been excessive and such excess is substantial in amount, whether or not disallowed by the Commissioner as a deduction from net income, may be restored to the surplus account. No such amount shall be restored, however, unless it is shown that adequate depreciation has been deducted upon all other property of the corporation still in use, nor in any case in which such amount has been allowed as a deduction for amortization under section 234 (a) (8) of the statute, or in which the cost of the property has been recovered through being included in the price of goods or services, as for example, in the case of patterns, dies, plates, special tools, etc., or under a munition contract with a foreign government.

(2) Amounts which have been expended before January 1, 1917, for the acquisition of plant, equipment, tools, patterns, furniture, fixtures, or like tangible property, having a useful life extending substantially beyond the year in which the expenditure was made, and which have been charged as current expense, may (less proper deductions for depreciation or obsolescence) be added to the surplus account when such assets are still owned and in active use by the corporation during the taxable year. Special tools, patterns, and similar assets shall not be assigned any value if their cost has been recovered through having been included in the price of goods. If their cost has not been so recovered and they are held for only occasional use, they shall not be assigned a value in excess of the fair value based upon the earnings actually arising from their current use, and in no case shall such value be more than the cost less depreciation. Assets of this kind not in current use shall not be valued at more than their nominal or scrap value.

(3) Amounts which have been expended in the past for intangible property of any kind can be restored to capital or surplus account only to the extent that the corporation specifically paid such amounts for the intangible property as such. For provisions relating to patents see article 843.

(4) Adjustments necessary to correct other errors found in the books of account may be made. But see the following article.

ART. 841. **Surplus and undivided profits: limitation of additions to surplus account.**—Additions to surplus which a corporation may desire to make under the preceding article fall broadly into two classes:

(1) To correct returns of net income for prior years in which actual errors have been made, as for example where excessive depreciation has been deducted, additions to plant and equipment or other capital charges have been charged off as an expense, inventories have been taken upon a wrong basis of valuation, etc.

(2) To reinstate in surplus deductions from income which are as a matter of good accounting to some extent optional, such as experimental expenses, patent litigation, development of good will through advertising or otherwise, etc.

Adjustments falling in class (1) will be permitted for all years whether before or after March 1, 1913, provided amended returns of net income are filed for each year in which an erroneous return has been made. Due consideration will be given to the assessment of penalties in any case in which a fraudulent return has been made. Adjustments falling in class (2) can not be permitted, as in such cases it is considered that the corporation has exercised a binding option in deducting such expenses from income. An election of this sort which was made concurrently with the transaction can not now be revised, and amended returns in respect thereof can not be accepted. The corporation shall submit with its return a statement of the additions proposed, specifying the kinds and amounts of property involved, the years in which the expenditures were made, and the method followed in distinguishing between capital outlays and current expenses, and showing that adequate provision has been made for depreciation, obsolescence, and depletion of such of the assets affected by the additions as are subject to recognized depreciation, obsolescence or depletion. In any case in which there is an operating deficit amounts restored must first be set off against the deficit and only the excess can be actually included in the computation of invested capital.

ART. 842. **Surplus and undivided profits: property paid in and subsequently written off.**—Where tangible or intangible property has been paid in to a corporation for stock or shares or as paid-in surplus, and has subsequently been in whole or in part written off the books, the amount so written off may upon evidence satisfactory to the Commissioner be restored to the capital or surplus account subject to the following limitations:

(1) The amount restored must be reduced by a proper deduction for any depreciation, obsolescence, or depletion; and

(2) The aggregate amount included in computing invested capital on account of such property shall not exceed the amount which might have been included if such property had not been written off.

ART. 843. **Surplus and undivided profits: patents.**—From the standpoint of assets a patent, or more particularly a group of patents, is closely analogous to good will. Their value is contingent upon and measured by their earning power. While patents have a definite life, there is a common tendency to extend that life by improvements upon the original, and in a successful business the patent value merges more or less completely into a trade name or other form of good will. Therefore, while deductions in respect to the depreciation of patents based upon a normal life period of seventeen years are allowable in computing net income for the purpose of the income tax, such deductions are not obligatory, but are optional with each taxpayer. Where since January 1, 1909, a corporation has exercised that option to its own benefit in computing its taxable net income the amount so deducted can not now be restored in computing invested capital. Where, however, the cost of patents has been charged against surplus or otherwise disposed of in such a manner as not to benefit the corporation in computing its taxable net income since January 1, 1909, any amount so written off may be restored in computing invested capital, if it be shown to the satisfaction of the Commissioner that the amount so written off represented a mere book entry ascribable to a conservative policy of management or accounting and did not represent a realized shrinkage in the value of such assets. Any amount so restored may not be written off by way of deductions from taxable net income in any subsequent year or years. Where a corporation has charged to current expenses the cost of developing or protecting patents, no amount in respect thereof expended since January 1, 1909, can be restored in computing invested capital. In respect of expenditures made before January 1, 1909, a corporation now seeking to restore them must be prepared to show to the satisfaction of the Commissioner that all such items are proper capital expenditures. It can not be said that the correct computation of surplus and undivided profits necessarily requires a deduction in respect of the expiration of patents. It follows, therefore, that where a corporation in the exercise of its option has not written down the cost of patents, it is not ordinarily necessary to reduce the surplus and undivided profits in computing invested capital, whether the patents have been acquired for stock or shares or for cash or other tangible property. Due consideration will be given to the facts in any case in which this rule seems obviously unreasonable. See article 167.

ART. 844. **Surplus and undivided profits: reserve for depreciation or depletion.**—If any reserves for depreciation or for depletion are included in the surplus account it should be analyzed so as to separate such reserves and leave only real surplus. Reserves for depreciation or depletion can not be included in the computation of invested capital, except to the following extent:

(1) Excessive depletion or depreciation included therein and which if charged off could be restored under article 840 may be included in the computation of invested capital; and

(2) Where depreciation or depletion is computed on the value as of March 1, 1913, or as of any subsequent date, the proportion of depreciation or depletion representing the realization of appreciation of value at March 1, 1913, or such subsequent date, may if undistributed and used or employed in the business be treated as surplus and included in the computation of invested capital.

For the purpose of computing invested capital depreciation or depletion computed on the value as of March 1, 1913, or as of any subsequent date shall, if such value exceeded cost, be deemed a pro rata realization of cost and appreciation and be apportioned accordingly. Except as above provided value appreciation (even though evidenced by an appraisal) which has not been actually realized and in respect of amounts accrued since March 1, 1913, reported as income for the purpose of the income tax, can not be included in the computation of invested capital, and if already reflected in the surplus account it must be deducted therefrom.

ART. 845. **Surplus and undivided profits: reserve for income and excess profits taxes.**—For the purpose of computing invested capital federal income and war profits and excess profits taxes are deemed to have been paid out of the net income of the taxable year for which they are levied. It is immaterial, therefore, whether reserves for the payment of such taxes for the preceding year have been set up or not, or if set up whether such taxes when paid have actually been charged against such reserves. Amounts payable on account of such taxes for the preceding year may be included in the computation of invested capital only until such taxes become due and payable. A deduction from the invested capital as of the beginning of the taxable year must therefore be made for such taxes or any installment thereof, averaged for the proportionate part of the taxable year after the date when the tax or the installment is due and payable. Where as a result of an audit by the Commissioner, or the acceptance of an amended return, or for any other reason, the amount of any such tax for the preceding year is subsequently changed, a corresponding adjustment will be made in the invested capital for the taxable year upon the same basis as if the corrected amount of the tax for the preceding year had been used in the original computation of the invested capital for the taxable year. See articles 1541 and 1542.

ART. 845(a). **Surplus and undivided profits: reserve for 1918 income and excess profits taxes of corporations having a fiscal year.**—In case of corporations having a fiscal year, the Federal income and profits taxes for the taxable year 1918 shall, for the purpose of computing invested capital for the taxable year 1919 be deemed to become due and payable as follows: (*a*) As to such amounts as became due and payable prior to February 25, 1919, under the provisions of section 14 (*a*), Revenue Act of 1916, such law shall govern; (*b*) in all other respects the provisions of section 250 of the Revenue Act of 1918 shall govern except that the installments which would become due prior to February 25, 1919, shall be deemed to become due and payable on that date; (*c*) any amounts which became due and payable under said section 14 (a) prior to February 25 shall, so far as possible, be deemed to cancel earlier installments payable under said section 250. For example, a corporation whose fiscal year ended August 31, 1918, is assessed a total income and profits tax under the 1917 law of $250,000 and an additional tax under the 1918 law of $110,000. The total tax of $360,000 would, for the purpose of computing invested capital, be deemed to become due and payable as follows: February 12, 1919, $250,000; May 15, 1919, $20,000; August 15, 1919, $90,000. If, assuming the same taxes, the fiscal year ended September 30, 1918, the total tax would for the purpose of computing invested capital, be deemed to become due and payable as follows: February 25, 1919, $90,000; March 15, 1919, $90,000; June 15, 1919, $90,000; September 15, 1919, $90,000. The provisions of this article apply solely for the purpose of computing invested capital and do not affect the provisions of T. D. 2797 in regard to the time and manner of paying taxes where corporations have filed returns for fiscal years ending in 1918.

ART. 846. **Surplus and undivided profits: insurance on officers.**—Where insurance is carried by the corporation on the life of an officer or employee, the policy may be included as an admissible asset and reflected in the surplus account at the cash surrender value as of the beginning of the taxable year. The whole amount of premiums paid on such insurance can not be included in surplus, but the surplus will be considered as increased as of the beginning of each taxable year by the amount added to the cash surrender value of the policy. See article 294.

ART. 847. **Surplus and undivided profits: property taken for debt or in exchange.**—Real or personal property taken by a corporation in payment or satisfaction of a debt, or property received in exchange for other property, will be an admissible asset at its fair market value upon receipt. The profit or loss, if any, resulting from the transaction will not be reflected in invested capital until the succeeding taxable year. But see as to the foreclosure of a mortgage article 153. See also section 202 of the statute and articles 1561–1570.

ART. 848. **Surplus and undivided profits: discount on sale of bonds.**—Discount allowed on the sale of bonds is in effect an advance on account of interest, so that the effective rate of interest in such a case is equal to the sum of the nominal rate plus the rate necessary to amortize the discount over the life of the bonds. Where, under incorrect accounting practices, the discount on bonds has been charged to a property account or otherwise carried as an asset, and is so reflected in the surplus account, it is necessary in computing invested capital to make an adjustment in respect of such discount. See article 563.

ART. 849. **Surplus and undivided profits: miscellaneous.**—Only the amount of discount which has actually been reported by a bank in a prior year as taxable income and credited to surplus account may be included in surplus as of the beginning of the taxable year. For the treatment of surplus arising out of sales on the installment plan see articles 42–46, and from compensation for property lost, damaged, or condemned see articles 49 and 50.

ART. 850. **Surplus and undivided profits: current profits.**—Profits earned during any year can not be included in the computation of invested capital for that year, even though during the year such profits are set up as surplus on the books or assumed to be distributed in the form of stock dividends. If a dividend is declared and paid during any year out of the profits of that year and the stockholders pay back into the corporation all or a substantial part of the amount of such dividends, the amount so paid back can not be included in the computation of invested capital unless the corporation shows by evidence satisfactory to the Commissioner that the dividends were paid in good faith and without any understanding, express or implied, that they were to be paid back.

ART. 851. **Intangible property paid in.**—The actual cash value of intangible property paid in for stock or shares must be determined in the light of the facts in each case. Among the factors to be considered are (*a*) the earnings attributable to such intangible assets while in the hands of the predecessor owner; (*b*) the earnings of the corporation attributable to the intangible assets after the date of their acquisition; (*c*) representative sales of the stock of the corporation at or about the date of the acquisition of the intangible assets; and (*d*) any cash offers for the purchase of the business, including the intangible property, at or about the time of its acquisition. A corporation claiming a value for intangible property paid in for stock or shares should file with its return a full statement of the facts relating to such valuation. See also article 835.

Art. 852. **Percentage of inadmissible assets.**—For the purpose of ascertaining the deductible percentage under section 326(c) the amount of inadmissible assets held during the year may ordinarily be determined by dividing by two the sum of the amount of such assets held at the beginning of the year and the amount held at the end of the year. The total amount of admissible and inadmissible assets held during the year may ordinarily be determined by dividing by two the sum of the amount of such assets held at the beginning of the year and the amount at the end of the year. If at any time a substantial change has taken place either in the amount of inadmissible assets or in the total amount of admissible and inadmissible assets, the effect of such change shall be averaged exactly from the date on which it occurred. In any case where the Commissioner finds that either amount determined as above provided does not substantially reflect the average situation throughout the year, and that the amount of each kind of assets held on a given day of each month throughout the year or at more frequent regular intervals can be determined, the amount of inadmissible assets and the amount of both kinds of assets held during the year shall be determined by averaging the amounts held at such several times. In making the computations under this article the valuation at which each asset is carried shall be adjusted in accordance with the provisions of the statute and of the regulations relating to the valuation of assets for the purpose of computing invested capital, including in such adjustment the amount of reserves for depreciation, depletion, amortization and other reserves which represent the valuation of assets. It is immaterial whether any asset was acquired out of invested capital or out of profits earned during the year or borrowed capital.

Art. 853. **Changes in invested capital during year.**—The invested capital as of the beginning of any period of one year or less should be adjusted by an appropriate addition or deduction for each change in invested capital during the period. The amount so added or deducted in each case is the amount of the change averaged for the time remaining in the period during which it is in effect. The fraction used in finding such average is the number of days remaining in the period (including the day on which the change occurs) over the number of days in the period. Thus if a return is made for the calendar year ending December 31, 1918, and if $100,000 of additional capital was paid in on February 17, 1918, this addition to invested capital is in effect for 318 days, and the amount to be added to the invested capital as of the beginning of the year would be 318/365 of $100,000, or $87,123.29. If $50,000 of this amount was withdrawn on October 31, 1918, the amount to be deducted would be 62/365 of $50,000, or $8,493.15.

ART. 854. **Computation of average invested capital.**—For the purpose of computing invested capital for any period of one year or less each corporation shall add together its paid-in capital and its paid-in or earned surplus and undivided profits (under whatever name it may be called) as shown by its books at the beginning of the period. The total so obtained shall be adjusted (*a*) for any property paid in, or for any asset reflected in surplus and undivided profits, which is not carried on the books at the valuation prescribed by the statute or by the regulations, and (*b*) for any changes in paid-in capital or in paid-in or earned surplus and undivided profits (not including surplus and undivided profits earned during the period) occurring during the period, averaged for the time for which such changes are effective. See article 853. The total so obtained and adjusted is the average invested capital for the period, unless the corporation at any time during the period held any inadmissible assets, in which case such total must be reduced by a percentage thereof equal to the percentage which the amount of inadmissible assets held during the period is of the total amount of admissible and inadmissible assets held during the period. See article 852. The invested capital for any year during the prewar period is determined in the same manner as for the taxable year. The invested capital can not be determined by adding the amounts of the assets of a corporation.

ART. 855. **Invested capital for full year or less.**—In the case of a corporation making a return for a full year of 12 months, its invested capital for the year is the average invested capital for the year. In the case of a corporation making a return for a fractional part of a year, its invested capital for such period is the same fractional part of the averaged invested capital for such period, except that for the purpose of section 311 (a) (2) of the statute it is the full average invested capital for the period. In computing the tax under a return for a fractional part of a period the same purpose may sometimes be more readily effected by using the full average invested capital and taking a fractional part of the result, as in schedule III of form 1120, used for 1918. In schedule IV of the same form, however, the fractional part of the full average invested capital for the period should be used. See articles 720 and 853.

ART. 856. **Illustration of invested capital for fractional part of year.**—

A corporation was organized July 1, 1918, and makes a return for the six months ending December 31, 1918. The invested capital consists of $100,000 paid in on July 1 and $100,000 paid in on October 1. The average invested capital for such period would be $100,000 plus 92/184 (not 92/365) of $100,000, or $50,000, a total of $150,000. The invested capital for the period for the purpose of the tax would, however, be 6/12 of $150,000, or $75,000. But see section 311 (a) (2) of the statute.

ART. 857. **Method of determining available net income.**—Whether at the time of any payment made during the taxable year there is sufficient income of the taxable year available for such payment, or whether the surplus or undivided profits as of the beginning of the taxable year must be reduced by the amount of such payment, shall be determined according to the following principles:

(1) The aggregate amount of earnings of the taxable year available for all purposes up to any given date will be determined upon the basis of the same proportion of the net income for the taxable year (as finally determined for the purpose of income and war profits and excess profits taxes) as the part of the year already elapsed is of the entire year (determined in the manner provided in article 853), unless the corporation shows from its books or other records that a greater proportion of its earnings for the year was available on such date.

(2) The aggregate amount available will be deemed to be applied for the following purposes in the order in which they are stated: (*a*) accrued federal income and war profits and excess profits taxes for the taxable year (see article 845), and (*b*) dividends paid after the expiration of the first sixty days of the taxable year (see section 201 of the statute and article 1541) and other corporate purposes, including the purchase of outstanding stock of the corporation previously issued (see article 862). In any case where the above computation would be indeterminate because of the effect of the provisions of this article upon the invested capital for the year, the amount of such invested capital for the purpose of this computation may be deemed to be the invested capital as of the beginning of the taxable year, plus any additional capital paid in during such year and minus any specific withdrawal or liquidation of capital during such year.

Art. 858. **Effect of ordinary dividend.**—A dividend other than a stock dividend affects the computation of invested capital from the date when the dividend is payable and not from the date when it is declared, except that where no date is set for its payment the date when declared will be considered also the date when payable for the purpose of this article. For the purpose of computing invested capital a dividend paid after the expiration of the first sixty days of the taxable year will be deemed to be paid out of the net income of the taxable year to the extent of the net income available for such purpose on the date when it is payable. See article 857. The surplus and undivided profits as of the beginning of the taxable year will be reduced as of the date when the dividend is payable by the entire amount of any dividend paid during the first sixty days of the taxable year and by the amount of any other dividend in excess of the current net income available for its payment. In the case of a dividend paid during the first sixty days of a taxable year which exceeds in amount the surplus and undivided profits as of the beginning of the taxable year the excess will be deemed to be paid out of earnings of the taxable year available at the date when the dividend is payable, and to the extent that such earnings are insufficient it will be deemed to be a liquidation of paid-in capital or surplus. From the date when any dividend is payable the amount which the several stockholders are entitled to receive will be treated as if actually paid to them, whether or not it is so paid in fact, and the surplus and undivided profits, either of the taxable year or of the preceding years, will in accordance with the foregoing provisions be deemed to be reduced as of that date by the full amount of the dividend. Amounts paid to stockholders in anticipation of dividends, or amounts withdrawn by stockholders in excess of dividends declared, will in computing invested capital have the same effect as if actually paid as dividends. See also article 813, and see generally section 201 and articles 1541–1549.

ART. 859. **Effect of stock dividend.**—Neither the payment nor the receipt of a true stock dividend has any effect upon the amount of invested capital. Such items as appraised value of good will, appreciation in value of real estate or other tangible property, etc., although carried to surplus and distributed as stock dividends, can not in this manner be capitalized and included in computing invested capital. If a corporation has paid a stock dividend in excess of its true surplus, it can not be deemed to have any greater invested capital than could have been computed had no such stock dividend been paid.

ART. 860. **Impairment of capital.**—Capital or surplus actually paid in is not required to be reduced because of an impairment of capital in the nature of an operating deficit, except where there has been directly or indirectly a liquidation or return of their investment to the stockholders, in which case full effect must be given to any liquidation of the original capital.

ART. 861. **Surrender of stock.**—Where stock which has originally been issued or exchanged by the corporation for property (tangible or intangible) is returned to the corporation as a gift or for a consideration substantially less than its par value, the stock so returned shall not be treated as a part of the stock issued or exchanged for such property. The proceeds derived in cash or its equivalent from the resale of the stock so returned shall, however, be included in computing invested capital. See article 542.

ART. 862. **Purchase of stock.**—Where a corporation either directly or indirectly, as for example through a trustee, has prior to the taxable year bought its own stock, either for the purpose of retirement or of holding it in the treasury or for other purposes, the entire cost of such stock must be deducted from the aggregate invested capital as of the beginning of the taxable year, if such deduction has not already been made. Where such stock is purchased during the taxable year a deduction from the invested capital as of the beginning of the taxable year and effective from the date of such purchase is required only to the extent that such stock has not been purchased out of the undivided profits of the taxable year. See article 857. The full amount derived in cash or its equivalent from the resale of such stock may be included in the invested capital from the date of such resale, unless such stock had been purchased out of earnings of the taxable year. See article 542.

ART. 863. **Invested capital and other measures of capital.**—(*a*) The invested capital as here defined may differ from the capital as shown on the books of the corporation. In such event no changes should be made in the books themselves. The corporation should, however, in all cases keep a permanent record of the adjustments which are made in computing invested capital. (*b*) Section 1000 of the statute imposes a tax on the fair value of the capital stock of corporations. As in the case of the war profits and excess profits tax the invested capital is based upon the actual investment of the stockholders in the corporation, irrespective of the present value of its assets, and in the case of the capital stock tax the fair value looks to the present value of the corporation's assets, irrespective of the amount of the investment of the stockholders therein, the amount determined as the fair value of the capital stock for the purpose of the capital stock tax can have no bearing upon the determination of invested capital. See also article 1561.

ART. 864. **Affiliated corporations: invested capital.**—The invested capital of affiliated corporations, as defined in section 240 (b) of the statute and article 633, for the taxable year is the invested capital of the entire group treated as one unit operated under a common control. As a first step in the computation a consolidated balance sheet should be prepared in accordance with standard accounting practices, which will reflect the actual assets and liabilities of the affiliated group. In preparing such a balance sheet all intercompany items, such as intercompany notes and accounts receivable and payable, should be eliminated from the assets and the liabilities, respectively, and proper adjustments should be made in respect of intercompany profits or losses reflected in inventories which at the beginning or end of the taxable year contain merchandise exchanged between the corporations included in the affiliated group at prices above or below cost to the producing or original owner corporation. Such consolidated balance sheet will then show (*a*) the capital stock of the parent or principal company in the hands of the public; (*b*) the consolidated surplus belonging to the stockholders of the parent or principal company; and (*c*) the capital stock, if any, of subsidiary companies of which substantially all the capital stock is not owned or controlled by the parent or principal company, together with the surplus, if any, belonging to such minority interest. In computing consolidated invested capital the starting point is furnished by the total of the amounts shown under (*a*), (*b*), and (*c*) above. This total must be increased or diminished by any adjustments required to be made under the provisions of sections 325, 326, 330, and 331 of the statute and articles 811–818, 831–869, 931–934, and 941 of the regulations, except as otherwise provided in articles 865–868.

ART. 865. **Affiliated corporations: intangible property paid in.**—(1) In respect of corporations whose affiliation is in the nature of parent and subsidiary companies: (*a*) in the case of intangible property bona fide paid in for stock or shares prior to March 3, 1917, there may be included in invested capital an amount not exceeding the actual cash value of such property at the time paid in, or the par value of the stock or shares issued therefor, or in the aggregate 25 per cent of the par value of the total stock or shares of the consolidation outstanding on March 3, 1917 (determined as indicated in items (*a*) and (*c*) in article 864), or in the aggregate 25 per cent of the par value of the total stock or shares shown on the consolidated balance sheet, being the amount of the capital stock included in items (*a*) and (*c*) in article 864 at the beginning of the taxable year, whichever is lowest; and (*b*) in the case of intangible property bona fide paid in for stock or shares on or after March 3, 1917, there may be included in invested capital an amount not exceeding the actual cash value of such property at the time paid in, or the par value of the stock or shares issued therefor, or in the aggregate 25 per cent of the par value of the total stock or shares shown by the consolidated balance sheet, being the amount of the capital stock included in items (*a*) and (*c*) in article 864 outstanding at the beginning of the taxable year, whichever is lowest. (*c*) When intangible property has been acquired in part before and in part after March 3, 1917, the amounts shall be ascertained, respectively, under (*a*) and (*b*) above and in the aggregate shall in no case exceed 25 per cent of the par value of the total stock or shares outstanding at the beginning of the taxable year shown in the consolidated balance sheet, being the amount of the capital stock included in items (*a*) and (*c*) in article 864.

(2) In respect of corporations affiliated by reason of stock ownership or control by the same interests, the limitations set forth in paragraphs (4) and (5) of subdivision (a) of section 326 of the statute shall be applied to each corporation separately and the aggregate of the intangible property, so valued, shall be included in invested capital in the consolidated return. In respect of each of the affiliated corporations the aggregate of the amounts ascertained under the provisions of paragraphs (4) and (5) shall in no case exceed 25 per cent of the outstanding capital stock of such corporation at the beginning of the taxable year.

ART. 866. **Affiliated corporations: inadmissible assets.**—Where adjustment is required in respect of inadmissible assets in accordance with the provisions of subdivision (c) of section 326 of the statute, such adjustment shall be made on the basis of the consolidated balance sheet with due regard to the adjustments and eliminations set forth in articles 864 and 865 and to the provisions of articles 815–818.

ART. 867. **Affiliated corporations: stock of subsidiary acquired for cash.**—When all or substantially all of the stock of a subsidiary corporation was acquired for cash, the cash so paid shall be the basis to be used in determining the value of the property acquired.

ART. 868. **Affiliated corporations: stock of subsidiary acquired for stock.**—Where stock of a subsidiary company was acquired with the stock of the parent company, the amount to be included in the consolidated invested capital in respect of the company acquired shall be computed in the same manner as if the net tangible assets and the intangible assets had been acquired instead of the stock. If in accordance with such acquisition a paid-in surplus is claimed, such claim shall be subject to the provisions of article 837.

ART. 869. **Affiliated corporations: invested capital for prewar period.**—The invested capital of affiliated corporations for the prewar period shall be computed on the same basis as the invested capital for the taxable year, except that where any one or more of the corporations included in the consolidation for the taxable year were in existence during the prewar period, but were not then affiliated as herein defined, then the average consolidated invested capital for the prewar period shall be the average invested capital of the corporations which were affiliated in the prewar period plus the aggregate of the average invested capital for each of the several corporations which were not affiliated during the prewar period. Full recognition, however, must be given to the provisions of section 330 of the statute, particularly the last paragraph thereof, and of articles 931–934.

ART. 870. **Insurance companies.**—The reserve funds of insurance companies, the net additions to which are deductible from gross income under the provisions of section 234 of the statute, cannot be included in computing invested capital. See sections 325 and 326(b) and articles 569 and 814.

ART. 871. **Foreign corporations.**—Inasmuch as the war profits and excess profits tax in the case of a foreign corporation is not based on the invested capital of the corporation, but is computed in accordance with section 328 of the statute, the provisions of section 326 and of articles 831–870 have no application to foreign corporations. For the same reason, when rendering a return of income on form 1120 for a foreign corporation, no entry of invested capital should be made thereon. See article 962.

SPECIAL CASES.

SEC. 327. That in the following cases the tax shall be determined as provided in section 328:

(a) Where the Commissioner is unable to determine the invested capital as provided in section 326;

(b) In the case of a foreign corporation;

(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively;

(d) Where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profit upon a normal invested capital nor (2) in which 50 per centum or more of the gross income of the corporation for the taxable year (computed under section 233 of Title II) consists of gains, profits, commissions, or other income, derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

ART. 901. **Treatment of special cases.**—In the cases specified in section 327 of the statute the tax will be specially determined under the provisions of section 328, but the tax will not ordinarily be computed under section 328 merely because the corporation's form or manner of organization, or the limitations imposed by section 326, result in a greater tax than would otherwise be payable. A corporation which comes within the provisions of subdivision (d) of section 327 may make application for assessment under the provisions of section 328, which application shall be attached to its return in the form of a statement setting forth in full: (*a*) the reasons why the tax should be so determined; (*b*) the facts upon which such reasons are based; (*c*) an exact description of each trade or business or important branch of a trade or business carried on by it; (*d*) a statement of the invested capital and net income for each year since the beginning of the prewar period; and (*e*) a statement showing the amount of gains, profits, commissions, or other income derived on a cost-plus basis from Government contracts made after April 5, 1917, and before November 12, 1918, and showing the per cent which such income is of the total income of the corporation. See sections 1 and 326 and articles 831–871 and 1510.

COMPUTATION OF TAX IN SPECIAL CASES.

SEC. 328. (a) In the cases specified in section 327 the tax shall be the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemption of $3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business bears to their average net income (in excess of the specific exemption of $3,000) for such year. In the case of a foreign corporation the tax shall be computed without deducting the specific exemption of $3,000 either for the taxpayer or the representative corporations.

In computing the tax under this section the Commissioner shall compare the taxpayer only with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are, as nearly as may be, similarly circumstanced with respect to gross income, net income, profits per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

(b) For the purposes of subdivision (a) the ratios between the average tax and the average net income of representative corporations shall be determined by the Commissioner in accordance with regulations prescribed by him with the approval of the Secretary.

In cases in which the tax is to be computed under this section, if the tax as computed without the benefit of this section is less than 50 per centum of the net income of the taxpayer, the installments shall in the first instance be computed upon the basis of such tax; but if the tax so computed is 50 per centum or more of the net income, the installments shall in the first instance be computed upon the basis of a tax equal to 50 per centum of the net income. In any case, the actual ratio when ascertained shall be used in determining the correct amount of the tax. If the correct amount of the tax when determined exceeds 50 per centum of the net income, any excess of the correct installments over the amounts actually paid shall on notice and demand be paid together with interest at the rate of ½ of 1 per centum per month on such excess from the time the installment was due.

(c) The Commissioner shall keep a record of all cases in which the tax is determined in the manner prescribed in subdivision (a), containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, and the amount of invested capital as determined under such subdivision. The Commissioner shall furnish a copy of such record and other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257.

ART. 911. **Computation of tax in special cases.**—In the cases specified in section 327 of the statute the tax is to be computed by comparison with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are engaged in a like or similar trade or business and similarly circumstanced. The provisions of section 328 do not permit the determination of a general average for any trade or business. In each case which comes under the provisions of section 327 the Commissioner will determine, as nearly as may be, the group or class of corporations with which the corporation should be compared and the amount which bears the same ratio to the net income of the corporation (in excess of the specific exemption of $3,000) for the taxable year as the average tax of such representative corporations bears to their average net income (in excess of the specific exemption of $3,000) for such year. The comparison will take account of similarity with respect to gross income, net income, profit per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

ART. 912. **Determination of first installment of tax in special cases.**—In the case of any corporation, other than a foreign corporation, where absolutely no data are available for the determination of the invested capital for the taxable year, the installments of the tax shall in the first instance be determined upon the basis of a war profits and excess profits tax equal to 50% of the net income. In any other case under section 328 of the statute, other than the case of a foreign corporation, but including a case where the invested capital for the taxable year can not be accurately determined, but where a minimum amount of invested capital as to which there is no question can be determined, the installments shall in the first instance be determined upon the basis of a war profits and excess profits tax computed by using the minimum invested capital, such tax not to exceed an amount equal to 50% of the net income.

ART. 913. **Determination of first installment of tax in the case of foreign corporation.**—In the case of a foreign corporation the installments of the tax shall in the first instance be determined upon the basis of a war profits and excess profits tax computed by using its invested capital for the taxable year 1917, such tax not to exceed an amount equal to 50% of the net income. For the purpose of this article the invested capital for 1917 shall be adjusted for any subsequent changes in its amount due to cash or property paid in or withdrawn or to surplus or undivided profits of prior years retained in the business and properly attributable to its business within the United States. If the tax for 1917 was determined under section 210 of the Revenue Act of 1917, the constructive capital which would result in a tax equivalent to the tax determined under that section shall be used.

ART. 914. **Payment of tax in special cases.**—In any case falling under the last two articles the installments shall be paid upon the basis therein provided until the Commissioner notifies the corporation of the amount of tax computed under section 328. The installments shall then be recomputed upon the basis of a war profits and excess profits tax of such amount, and if the amount already paid is less than the amount which would have already become due if the installments had originally been computed upon that basis, the additional amount shall be due and payable ten days after notice and demand from the collector.

REORGANIZATIONS.

SEC. 330. That in the case of the reorganization, consolidation, or change of ownership after January 1, 1911, of a trade or business now carried on by a corporation, the corporation shall for the purposes of this title be deemed to have been in existence prior to that date, and the net income and invested capital of such predecessor trade or business for all or any part of the prewar period prior to the organization of the corporation now carrying on such trade or business shall be deemed to have been the net income and invested capital of such corporation.

If such predecessor trade or business was carried on by a partnership or individual the net income for the prewar period shall, under regulations prescribed by the Commissioner with the approval of the Secretary, be ascertained and returned as nearly as may be upon the same basis and in the same manner as provided for corporations in Title II, including a reasonable deduction for salary or compensation to each partner or the individual for personal services actually rendered.

In the case of the organization as a corporation before July 1, 1919, of any trade or business in which capital is a material income-producing factor and which was previously owned by a partnership or individual, the net income of such trade or business from January 1, 1918, to the date of such reorganization may at the option of the individual or partnership be taxed as the net income of a corporation is taxed under Titles II and III; in which event the net income and invested capital of such trade or business shall be computed as if such corporation had been in existence on and after January 1, 1918, and the undistributed profits or earnings of such trade or business shall not be subject to the surtax imposed in section 211, but amounts distributed on or after January 1, 1918, from the earnings of such trade or business shall be taxed to the recipients as dividends, and all the provisions of Titles II and III relating to corporations shall so far as practicable apply to such trade or business: *Provided*, That this paragraph shall not apply to any trade or business the net income of which for the taxable year 1918 was less than 20 per centum of its invested capital for such year: *Provided further*, That any taxpayer who takes advantage of this paragraph shall pay the tax imposed by section 1000 of this Act and by the first subdivision of section 407 of the Revenue Act of 1916, as if such taxpayer had been a corporation on and after January 1, 1918, with a capital stock having no par value.

If any asset of the trade or business in existence both during the taxable year and any prewar year is included in the invested capital for the taxable year but is not included in the invested capital for such prewar year, or is valued on a different basis in computing the invested capital for the taxable year and such prewar year, respectively, then under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary such readjustments shall be made as are necessary to place the computation of the invested capital for such prewar year on the basis employed in determining the invested capital for the taxable year.

ART. 931. **Scope of reorganizations.**—The first two paragraphs of section 330 of the statute relate only to the prewar period and not to the invested capital or net income for the taxable year. Under their provisions in the case of a reorganization, consolidation or change of ownership, the corporation is regarded as having been in existence prior to the date of such reorganization, consolidation or change in ownership, and the net income and invested capital of the predecessor trade or business for all or any part of the prewar period prior to the organization of the present corporation are deemed to have been the net income and invested capital of such corporation.

ART. 932. **Net income and invested capital of predecessor partnership or individual.**—If the predecessor trade or business was carried on by a partnership or individual, the corporation shall make its return of the net income and invested capital of such trade or business as nearly as may be in the same manner as if such trade or business had been carried on by a corporation. It shall submit with its return a statement setting forth (*a*) the manner in which such trade or business was carried on and (*b*) the points, if any, in which the provisions of the statute and of the regulations are not fully applicable to the determination of the net income or invested capital of the predecessor trade or business for the prewar period. In no case shall the deduction from gross income for salary or compensation for personal services exceed the salaries or compensation customarily paid at that time by corporations or partnerships of similar size and standing engaged in similar trades or businesses for similar services under like responsibilities.

ART. 933. **Election to be taxed as corporation.**—A business enterprise (*a*) which is organized as a corporation before July 1, 1919, (*b*) in which capital is and has been a material income-producing factor, and (*c*) which was previously owned by a partnership or individual, may elect to be taxed as a corporation on its net income from January 1, 1918, to the date of organization of the corporation. In such event the corporation shall be treated as if in existence since January 1, 1918, for the purposes of the income tax, the war profits and excess profits tax, and the capital stock tax. The adoption of any other date than January 1, 1918, for such purpose is not permissible. But this option is not extended to a business enterprise with a net income for the taxable year 1918 less than 20 per cent of its invested capital.

ART. 934. **Adjustment for asset differently valued in prewar invested capital.**—In any case in which as a result of a reorganization or for any other reason any asset in existence both during the taxable year and any prewar year is included in computing the invested capital for the taxable year, but is not included in computing the invested capital for such prewar year, or is valued on a different basis in computing the invested capital for the two years, the difference resulting therefrom shall not be included in determining the difference 10 per cent of which is added to or deducted from the war profits credit under section 311 (a) (2) of the statute. In any such case the corporation shall make the readjustment required by the statute, and shall submit with its return a full statement of the difference in such valuations and of the facts which give rise to such difference. See also section 331 and article 941.

VALUATION OF ASSETS UPON REORGANIZATION.

SEC. 331. In the case of the reorganization, consolidation, or change of ownership of a trade or business, or change of ownership of property, after March 3, 1917, if an interest or control in such trade or business or property of 50 per centum or more remains in the same persons, or any of them, then no asset transferred or received from the previous owner shall, for the purpose of determining invested capital, be allowed a greater value than would have been allowed under this title in computing the invested capital of such previous owner if such asset had not been so transferred or received: *Provided*, That if such previous owner was not a corporation, then the value of any asset so transferred or received shall be taken at its cost of acquisition (at the date when acquired by such previous owner) with proper allowance for depreciation, impairment, betterment or development, but no addition to the original cost shall be made for any charge or expenditure deducted as expense or otherwise on or after March 1, 1913, in computing the net income of such previous owner for purposes of taxation.

ART. 941. **Valuation of asset upon change of ownership.**—Where a business is reorganized, consolidated or transferred, or property is transferred, after March 3, 1917, and an interest or control of 50 per cent or greater in such business or property remains in any of the previous owners, then for the purpose of determining invested capital each asset so transferred is valued (*a*) as if still in the possession of the previous owner, if a corporation, or, if not a corporation, (*b*) at its cost to such previous owner, with proper adjustments for losses and improvements. This provision is accordingly concerned with the computation of invested capital for the taxable year, while section 330 of the statute is chiefly concerned with the determination of invested capital for the prewar period. See articles 931, 932 and 1561–1570.

FISCAL YEARS ENDING IN 1918 OR 1919.

SEC. 335. (a) That if a corporation (other than a personal service corporation) makes return for a fiscal year beginning in 1917 and ending in 1918, the tax for the first taxable year under this title shall be the sum of: (1) the same proportion of a tax for the entire period computed under Title II of the Revenue Act of 1917 which the portion of such period falling within the calendar year 1917 is of the entire period, and (2) the same proportion of a tax for the entire period computed under this title at the rates specified in subdivision (a) of section 301 which the portion of such period falling within the calendar year 1918 is of the entire period.

Any amount heretofore or hereafter paid on account of the tax imposed for such fiscal year by Title II of the Revenue Act of 1917 shall be credited toward the payment of the tax imposed for such fiscal year by this title, and if the amount so paid exceeds the amount of the tax imposed by this title, the excess shall be credited or refunded to the corporation in accordance with the provisions of section 252.

(b) If a corporation makes return for a fiscal year beginning in 1918 and ending in 1919, the tax for such fiscal year under this title shall be the sum of: (1) the same proportion of a tax for the entire period computed under subdivision (a) of section 301 which the portion of such period falling within the calendar year 1918 is of the entire period, and (2) the same proportion of a tax for the entire period computed under subdivision (b) or (c) of section 301 which the portion of such period falling within the calendar year 1919 is of the entire period.

(c) If a partnership or a personal service corporation makes return for a fiscal year beginning in 1917 and ending in 1918, it shall pay the same proportion of a tax for the entire period computed under Title II of the Revenue Act of 1917 which the portion of such period falling within the calendar year 1917 is of the entire period.

Any tax paid by a partnership or personal service corporation for any period beginning on or after January 1, 1918, shall be immediately refunded to the partnership or corporation as a tax erroneously or illegally collected.

ART. 951. **Fiscal year with different rates.**—Section 335 of the statute applies to the war profits and excess profits tax. For provisions with respect to the income tax see section 205 of the statute and articles 1621–1625. Subdivision (a), which deals with fiscal years beginning in 1917 and ending in 1918, and subdivision (b) which deals with fiscal years beginning in 1918 and ending in 1919, apply to corporations other than personal service corporations. Subdivision (c), which deals with fiscal years beginning in 1917 and ending in 1918, applies to partnerships and to personal service corporations. See as to partnerships articles 321–327 and as to personal service corporations articles 328–335. See also section 252 of the statute and articles 1034–1036. Partnerships and personal service corporations having fiscal years beginning in 1918 and ending in 1919 are not subject to the war profits and excess profits tax.

ART. 952. **Fiscal year of corporation ending in 1918.**—The method provided for computing the tax for a fiscal year beginning in 1917 and ending in 1918 is as follows: (*a*) the tax attributable to the calendar year 1917 is found by computing the income of the taxpayer and the tax thereon in accordance with Title II of the Revenue Act of 1917 as if the fiscal year was the calendar year 1917, and determining the proportion of such tax which the number of months falling within the calendar year 1917 is of the number of months in the entire period; (*b*) the tax attributable to the calendar year 1918 is found by computing the income of the taxpayer and the tax thereon in accordance with the present statute as if the fiscal year was the calendar year 1918, and determining the proportion of such tax which the number of months falling within the calendar year is of the number of months in the entire period; and (*c*) the tax for the fiscal year is found by adding the tax attributable to the calendar year 1917 and the tax attributable to the calendar year 1918.

ART. 953. **Deductions and credits in the case of fiscal year ending in 1918.**—Net losses deductible from net income of the fiscal year under the provisions of section 204 of the statute shall be deductible in computing the tax attributable to the calendar year 1917 as well as in computing the tax attributable to the calendar year 1918. See articles 1601–1603. Amounts previously paid by the taxpayer on account of the excess profits tax for its fiscal year ending in 1918 shall be credited towards the payment of the war profits and excess profits tax imposed for such fiscal year by the present statute. Any excess shall be credited or refunded in accordance with the provisions of section 252 of the statute. For credits for foreign taxes see section 238 of the statute and article 611.

ART. 954. **Fiscal year of corporation ending in 1919.**—The method provided for computing the tax for a fiscal year beginning in 1918 and ending in 1919 is as follows: (*a*) the tax attributable to the calendar year 1918 is found by computing the income of the taxpayer and the tax thereon in accordance with the statute as if the fiscal year was the calendar year 1918, and determining the proportion of such tax which the number of months falling within the calendar year 1918 is of the number of months in the entire period; (*b*) the tax attributable to the calendar year 1919 is found by computing the income of the taxpayer and the tax thereon in accordance with the statute as if the fiscal year was the calendar year 1919, and determining the proportion of such tax which the number of months falling within the calendar year 1919 is of the number of months in the entire period; and (*c*) the tax for the fiscal year is found by adding the tax attributable to the calendar year 1918 and the tax attributable to the calendar year 1919. For credits for foreign taxes see section 238 of the statute and article 611.

ART. 955. **Illustration of computation of tax for fiscal year.**—

A corporation makes its return on the basis of a fiscal year ending March 31. It had an average prewar invested capital of $50,000 and an average prewar net income of $3,500. For the fiscal year ending March 31, 1918, its invested capital and net income are $100,000 and $75,000, respectively, as computed under Title

II of the Revenue Act of 1917, and $125,000 and $70,000, respectively, as computed under the present statute. Such a difference in these amounts as computed under the two acts may readily occur where, for example, a corporation is allowed under the present statute a deduction for interest, amortization, etc., which it was not allowed under the Revenue Act of 1917, or where, under the present statute, it is allowed a greater amount of invested capital on account of intangible property paid in for stock or shares than allowed under the Revenue Act of 1917. For the fiscal year ending March 31, 1919, its invested capital and net income are $125,000 and $60,000, respectively.

(1) A war excess profits tax for the year ending March 31, 1918, as computed under the provisions of Title II of the Revenue Act of 1917, and upon the basis of an invested capital of $100,000 and a net income of $75,000 as computed under that Act, is $32,800. For the details of this computation see illustration (1) under article 16 of Regulations 41. A war profits and excess profits tax for the entire period as computed under subdivision (a) of section 301 of the present statute, and upon the basis of an invested capital of $125,000 and a net income of $70,000 as computed under the statute, is $43,600. Section 335 provides that the tax for this period is the sum of 9/12 of the tax of $32,800 as computed under the Revenue Act of 1917, or $24,600, plus 3/12 of the tax of $43,600 as computed under the present statute, or $10.900, making a total war excess profits tax for the fiscal year ending March 31, 1918, of $35,500.

(2) A war profits and excess profits tax for the year ending March 31, 1919, as computed under subdivision (a) of section 301 of the statute is $35,600. A war profits and excess profits tax for the entire period as computed under subdivision (b) of section 301 is $16.400. Section 335 provides that the tax for this period is the sum of 9/12 of the tax of $35,600, as computed under subdivision (a) of section 301, or $26,700, plus 3/12 of the tax of $16,400, as computed under subdivision (b) of section 301, or $4,100, making a total war profits and excess profits tax for the fiscal year ending March 31, 1919, of $30,800.

RETURNS.

> SEC. 336. That every corporation, not exempt under section 304, shall make a return for the purposes of this title. Such returns shall be made, and the taxes imposed by this title shall be paid, at the same times and places, in the same manner, and subject to the same conditions, as is provided in the case of returns and payment of income tax by corporations for the purposes of Title II, and all the provisions of that title not inapplicable, including penalties, are hereby made applicable to the taxes imposed by this title.

ART. 961. **Returns.**—Every corporation, domestic or foreign, not exempt under section 304 of the statute and article 751, shall make a return for the purpose of the war profits and excess profits tax on form 1120. The return shall be made and the tax shall be paid as provided in the case of a return for and payment of the income tax by corporations. See generally Parts II A and III of the regulations, and particularly sections 239, 240, 241, 250, and 253 of the statute and the articles thereunder.

ART. 962. **Returns in special cases.**—Where a corporation computes its war profits credit upon the basis of the sum of (*a*) the specific exemption and (*b*) an amount equal to 10 per cent of the invested capital for the taxable year, the items on form 1120 which relate solely to the net income or to the invested capital for the prewar period need not be filled in. Where a corporation enters on its return a war profits and excess profits tax equal to the amount of the maximum tax determined under section 302 of the statute, the items on form 1120 which relate solely to the net income for the prewar period and the items which relate to the invested capital for the prewar period and for the taxable year need not be filled in. Likewise in the case of a foreign corporation the same items may be disregarded, except that balance sheets as of the beginning and the end of the taxable year for the entire business of the corporation both within and without the United States shall be submitted. See article 871. The Commissioner may at any time specifically call for all or any part of the information which under this article is not required to be entered on the return. In any case, however, where a claim is made under sections 327 and 328 of the statute, other than in the case of a foreign corporation, the corporation should fill out all items of the return so far as possible and submit a statement explaining why it is impracticable to fill out the entire return.

SALE OF MINERAL DEPOSITS.

SEC. 337. That in the case of a bona fide sale of mines, oil or gas wells, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, the portion of the tax imposed by this title attributable to such sale shall not exceed 20 per centum of the selling price of such property or interest.

ART. 971. **Tax on sale of mineral deposits.**—In the case of a sale of mines, oil or gas wells, or any interest therein, as described in article 13, the portion of the war profits and excess profits tax attributable to such a sale shall not exceed 20 per cent of the selling price. To determine the application of this provision to a particular case the corporation should compute the war profits and excess profits tax in the ordinary way upon its net income, including its net income from any such sale. The proportion of the total tax indicated by the ratio which the taxpayer's net income from the sale of the property, computed as prescribed in article 715, bears to its total net income is the portion of the tax attributable to such sale, and if it exceeds 20 per cent of the selling price of the property such portion of the tax shall be reduced to that amount. See articles 219, 220, 220(a), and 221.

ART. 972. **Illustration of computation of tax where sale of mineral deposits.**—

In the case of the corporation used as an illustration in article 716, let it be assumed that its gross income for 1918 included $15,000 derived from a bona fide sale of an oil well, the principal value of which had been demonstrated by exploration and discovery work done by the corporation, and that the Commissioner finds under article 715 that only $800 of the deductions allowed are properly applicable to the gross income derived from the sale. The portion of the net income attributable to the sale would be $14,200, which is 35.5 per cent of the entire net income of $40,000, and the portion of the tax for that year attributable to the sale will be 35.5 per cent of the entire tax of $17,600, or $6,248. But this portion of the tax can not exceed 20 per cent of the selling price ($15,000) and is accordingly reduced to $3,000. The total tax will be $11,352 (the portion of the tax not affected) plus $3,000, or $14,352 (instead of $17,600).

PART III.

ADMINISTRATIVE PROVISIONS.

PAYMENT OF TAXES.

SEC. 250. (a) That except as otherwise provided in this section and sections 221 and 237 the tax shall be paid in four installments, each consisting of one-fourth of the total amount of the tax. The first installment shall be paid at the time fixed by law for filing the return, and the second installment shall be paid on the fifteenth day of the third month, the third installment on the fifteenth day of the sixth month, and the fourth installment on the fifteenth day of the ninth month, after the time fixed by law for filing the return. Where an extension of time for filing a return is granted the time for payment of the first installment shall be postponed until the date of the expiration of the period of the extension, but the time for payment of the other installments shall not be postponed unless the Commissioner so provides in granting the extension. In any case in which the time for the payment of any installment is at the request of the taxpayer thus postponed, there shall be added as part of such installment interest thereon at the rate of ½ of 1 per centum per month from the time it would have been due if no extension had been granted until paid. If any installment is not paid when due, the whole amount of the tax unpaid shall become due and payable upon notice and demand by the collector.

The tax may at the option of the taxpayer be paid in a single payment instead of in installments, in which case the total amount shall be paid on or before the time fixed by law for filing the return, or, where an extension of time for filing the return has been granted, on or before the expiration of the period of such extension.

(b) As soon as practicable after the return is filed, the Commissioner shall examine it. If it then appears that the correct amount of the tax is greater or less than that shown in the return, the installments shall be recomputed. If the amount already paid exceeds that which should have been paid on the basis of the installments as recomputed, the excess so paid shall be credited against the subsequent installments; and if the amount already paid exceeds the correct amount of the tax, the excess shall be credited or refunded to the taxpayer in accordance with the provisions of section 252.

If the amount already paid is less than that which should have been paid, the difference shall, to the extent not covered by any credits then due to the taxpayer under section 252, be paid upon notice and demand by the collector. In such case if the return is made in good faith and the understatement of the amount in the return is not due to any fault of the taxpayer, there shall be no penalty because of such understatement. If the understatement is due to negligence on the part of the taxpayer, but without intent to defraud, there shall be added as part of the tax 5 per centum of the total amount of the deficiency, plus interest at the rate of 1 per centum per month on the amount of the deficiency of each installment from the time the installment was due.

If the understatement is false or fraudulent with intent to evade the tax, then, in lieu of the penalty provided by section 3176 of the Revised Statutes, as amended, for false or fraudulent returns wilfully made, but in addition to other penalties provided by law for false or fraudulent returns, there shall be added as part of the tax 50 per centum of the amount of the deficiency.

(c) If the return is made pursuant to section 3176 of the Revised Statutes as amended, the amount of tax determined to be due under such return shall be paid upon notice and demand by the collector.

(d) Except in the case of false or fraudulent returns with intent to evade the tax, the amount of tax due under any return shall be determined and assessed by the Commissioner within five years after the return was due or was made, and no suit or proceeding for the collection of any tax shall be begun after the expiration of five years after the date when the return was due or was made. In the case of such false or fraudulent returns, the amount of tax due may be determined at any time after the return is filed, and the tax may be collected at any time after it becomes due.

(e) If any tax remains unpaid after the date when it is due, and for ten days after notice and demand by the collector, then, except in the case of estates of insane, deceased, or insolvent persons, there shall be added as part of the tax the sum of 5 per centum on the amount due but unpaid, plus interest at the rate of 1 per centum per month upon such amount from the time it became due: *Provided*, That as to any such amount which is the subject of a bona fide claim for abatement such sum of 5 per centum shall not be added and the interest from the time the amount was due until the claim is decided shall be at the rate of ½ of 1 per centum per month.

In the case of the first installment provided for in subdivision (a) the instructions printed on the return shall be deemed sufficient notice of the date when the tax is due and sufficient demand, and the taxpayer's computation of the tax on the return shall be deemed sufficient notice of the amount due.

(f) In any case in which in order to enforce payment of a tax it is necessary for a collector to cause a warrant of distraint to be served, there shall also be added as part of the tax the sum of $5.

(g) If the Commissioner finds that a taxpayer designs quickly to depart from the United States or to remove his property therefrom, or to conceal himself or his property therein, or to do any other act tending to prejudice or to render wholly or partly ineffectual proceedings to collect the tax for the taxable year then last past or the taxable year then current unless such proceedings be brought without delay, the Commissioner shall declare the taxable period for such taxpayer terminated at the end of the calendar month then last past and shall cause notice of such finding and declaration to be given the taxpayer, together with a demand for immediate payment of the tax for the taxable period so declared terminated and of the tax for the preceding taxable year or so much of said tax as is unpaid, whether or not the time otherwise allowed by law for filing return and paying the tax has expired; and such taxes shall thereupon become immediately due and payable. In any action or suit brought to enforce payment of taxes made due and payable by virtue of the provisions of this subdivision the finding of the Commissioner, made as herein provided, whether made after notice to the taxpayer or not, shall be for all purposes presumptive evidence of the taxpayer's design. A taxpayer who is not in default in making any return or paying income, war-profits, or excess-profits tax under any Act of Congress may furnish to the United States, under regulations to be prescribed by the Commissioner with the approval of the Secretary, security approved by the Commissioner that he will duly make the return next thereafter required to be filed and pay the tax next thereafter required to be paid. The Commissioner may approve and accept in like manner security for return and payment of taxes made due and payable by virtue of the provisions of this subdivision, provided the taxpayer has paid in full all other income, war-profits, or excess-profits taxes due from him under any Act of Congress. If security is approved and accepted pursuant to the provisions of this subdivision and such further or other security with respect to the tax or taxes covered thereby is given as the Commissioner shall from time to time find necessary and require, payment of such taxes shall not be enforced by any proceedings under the provisions of this subdivision prior to the expiration of the time otherwise allowed for paying such respective taxes.

ART. 1001. **Time for payment of tax.**—The tax, unless paid at the source, is to be paid to the collector in four equal installments, the first at the time for filing the return and the others at intervals of three months thereafter, or it may at the option of the taxpayer be paid in a single payment on or before the time for filing the return or such time as extended. See section 227 of the statute and articles 441–447. An unconditional extension of time for filing a return will postpone the date for payment of the first installment, but will not postpone the date of payment of the other installments unless so specified in each case. Upon failure to pay an installment on time, all of the tax remaining unpaid becomes due and payable upon notice and demand. Upon recomputation of the tax, if the amount already paid exceeds the correct amount of the installment or of the whole tax, the excess shall be credited against subsequent installments or other similar taxes then due from the taxpayer or, if there is no such installment or tax, shall be refunded to him; but if the amount already paid is less than the correct amount of the installment or tax then due, the difference shall be paid upon notice and demand. See article 1003, and section 252 and articles 1034–1036.

ART. 1002. **Payment of tax when no proper return.**—Section 3176 of the Revised Statutes, as amended by section 1317 of the Revenue Act of 1918, provides:

SEC. 3176. If any person, corporation, company or association fails to make and file a return or list at the time prescribed by law or by regulation made under authority of law, or makes, willfully or otherwise, a false or fraudulent return or list, the collector or deputy collector shall make the return or list from his own knowledge and from such information as he can obtain through testimony or otherwise.

In any such case the Commissioner may, from his own knowledge and from such information as he can obtain through testimony or otherwise, make a return or amend any return made by a collector or deputy collector. Any return or list so made and subscribed by the Commissioner, or by a collector or deputy collector and approved by the Commissioner, shall be prima facie good and sufficient for all legal purposes.

If the failure to file a return or list is due to sickness or absence, the collector may allow such further time, not exceeding thirty days, for making and filing the return or list as he deems proper.

The Commissioner of Internal Revenue shall determine and assess all taxes, other than stamp taxes, as to which returns or lists are so made under the provisions of this section. In case of any failure to make and file a return or list within the time prescribed by law, or prescribed by the Commissioner of Internal Revenue or the collector in pursuance of law, the Commissioner of Internal Revenue shall add to the tax 25 per centum of its amount, except that when a return is filed after such time and it is shown that the failure to file it was due to a reasonable cause and not to willful neglect, no such addition shall be made to the tax. In case a false or fraudulent return or list is willfully made, the Commissioner of Internal Revenue shall add to the tax 50 per centum of its amount.

The amount so added to any tax shall be collected at the same time and in the same manner and as part of the tax unless the tax has been paid before the discovery of the neglect, falsity, or fraud, in which case the amount so added shall be collected in the same manner as the tax.

Accordingly, if a return is not made on time or is false, and the collector or Commissioner makes a return, the amount of tax determined to be due under such substitute return shall be paid in full upon notice and demand by the collector. See further articles 443–446, 1004 and 1005.

ART. 1003. **Interest on tax.**—Where the time for the payment of any installment of the tax is postponed at the request of the taxpayer, interest at the rate of 6 per cent per annum is added from the original due date. If an understatement of the tax in the return is due to the negligence of the taxpayer, but without intent to defraud, interest at the rate of 12 per cent per annum is added to the amount of the deficiency of each installment from the time the installment was due. If any tax remains due and unpaid for ten days after notice and demand by the collector, or in the case of the first installment as computed by the taxpayer remains due and unpaid for ten days, interest at the rate of 12 per cent per annum is added from the due date, except that the interest on any amount which is the subject of a bona fide claim for abatement shall be at the rate of 6 per cent per annum, and except that no interest is added in the case of estates of insane, deceased or insolvent persons. But if any part of a claim for abatement on the ground of a loss in inventory under section 214 (a) (12) or section 234 (a) (14) of the statute is disallowed, interest from the original due date at the rate of 12 per cent per annum will be added to the tax not abated; and interest is to be added in all cases in which the demand of payment is made of the taxpayer personally, although he subsequently dies, or becomes insane or insolvent, so that collection of the tax is made from his estate in the hands of his representative. See further articles 1005 and 1006.

ART. 1004. **Penalty for failure to file return.**—In case of failure to make a return on time, a penalty of 25 per cent of the amount of the tax is added to it, unless the return is later filed and the failure to file it is satisfactorily shown to be due to a reasonable cause, and not to willful neglect. See article 1002. Two classes of delinquents are liable to the penalty: (*a*) those who do not file returns and for whom returns are made by the collector or Commissioner; and (*b*) those who file tardy returns and are unable to show reasonable cause for the delay. Taxpayers wishing to avoid the penalty must make an affirmative showing of the facts alleged as a reasonable cause for failure to make a return on time in the form of an affidavit under oath, which should be attached to the return. If such an explanation is furnished with the return or upon the collector's demand, the collector, unless otherwise directed by the Commissioner, will forward the affidavit with the return, and if the Commissioner determines that the delinquency was due to a reasonable cause the 25 per cent penalty will not be assessed. "Reasonable cause" is such a condition of fact that had the taxpayer in default exercised ordinary business care and prudence it would have been impracticable or impossible for him to file a return in the prescribed time. See article 445. See also section 253 of the statute and article 1041.

ART. 1005. **Penalty for understated return.**—(*a*) If an understatement of the amount of the tax in a return of income is due to negligence on the part of the taxpayer, but without intent to defraud, a penalty of 5 per cent of the amount of the deficiency is added; but (*b*) if the understatement of the tax is false or fraudulent with intent to evade the tax, a penalty of 50 per cent of the amount of the deficiency is added. See articles 1002 and 1003. In general, negligence is attributable to the taxpayer if he computes the tax in disregard of the instructions on the return form or otherwise incorrectly, unless he can show that his error was due to an honest misunderstanding of the facts or the law of which an average reasonable man might be capable. See also section 253 of the statute and article 1041.

ART. 1006. **Penalty for nonpayment of tax.**—If any tax or installment thereof remains due and unpaid for 10 days after notice and demand by the collector (the instructions on the return serve as notice and demand in the case of the first installment as computed by the taxpayer), a penalty of 5 per cent is added. When, however, upon an assessment of a tax and demand made for payment, a bona fide claim for its abatement is filed within 10 days after such demand, no penalty is imposed. Upon receipt of a notice of rejection of the claim (or so much thereof as is not allowed), the collector will notify the claimant and demand the payment of the tax. If the tax is not then paid within 10 days, the 5 per cent penalty will be assessed on the amount of tax not abated. If abatement of the entire tax assessed is not demanded in a claim, and the balance of the tax is not paid within the required 10 days, the 5 per cent penalty will immediately accrue on such balance. See also article 1003. The estate of a deceased person, regardless of the date of his death, or of an insane or insolvent person, can not be charged with liability to the 5 per cent penalty on account of his or the fiduciary's delinquency in making payment of taxes. Where a warrant of distraint is served, $5 is added. When serving distraint warrants the mode of procedure followed should conform to the mode of procedure prescribed by the State or Territory in which the warrant of distraint is to be served for the service of other process. For other penalties see section 253 of the statute and article 1041.

ART. 1007. **Notice and demand of payment.**—The service of a notice and demand by the collector on form 1-17a is complete upon mailing it, and the time within which the tax must be paid runs from the date of mailing the notice and not of its receipt by the taxpayer. But payment for the tax must actually reach the collector within the 10 day period, and merely mailing a remittance before the expiration of the 10 days is not sufficient. So, to avoid the prescribed penalties, no more than 10 days may elapse after the mailing of the notice before the payment is in the collector's hands. See section 3184 of the Revised Statutes. By reason, however, of absence from their homes or places of business in foreign countries or in the military or other service of the country and the consequent delay in receiving mail, or by reason of the location of the residence of an individual or of the office of a corporation to which the notice was addressed at a distance from the collector's office, it is impossible for many persons to receive a notice and demand and to make payment of the tax so that such payment may be received by the collector within the 10 day period following the service of notice and demand, and in all such cases the collector will enter on the notice as the date on which the tax becomes due and payable a date as nearly as possible 10 days after the time that the notice should be received in the ordinary course of the mails by the taxpayer. In such cases when it appears that a remittance for the tax was placed in the mails within the 10 day period after the date specified in the notice, and in cases where tardiness is occasioned because the notice was not delivered in due time by reason of delay in the mail and satisfactory evidence of that fact is furnished, the penalty and interest will not be collected.

ART. 1008. **Collection of tax by suit.**—Taxes, fines, penalties and forfeitures may be sued for and recovered in the name of the United States in the district courts of the United States. Suits for the collection of taxes may be brought at any time within five years after the return was due or was made, whether the taxes have been assessed, or are assessable, or not. In the case of false or fraudulent returns with intent to evade the tax no statute of limitations runs against the Government. Section 3164 of the Revised Statutes, as amended by section 1317 of the Revenue Act of 1918, provides:

> SEC. 3164. It shall be the duty of every collector of internal revenue having knowledge of any willful violation of any law of the United States relating to the revenue, within thirty days after coming into possession of such knowledge, to file with the district attorney of the district in which any fine, penalty, or forfeiture may be incurred, a statement of all the facts and circumstances of the case within his knowledge, together with the names of the witnesses, setting forth the provisions of law believed to be so violated on which reliance may be had for condemnation or conviction.

However, no suit for the recovery of unpaid taxes or of any fine, penalty or forfeiture shall be commenced until the collector shall have submitted to the Commissioner a full report of all material facts and circumstances in the case and shall have received from him express authority to proceed. See sections 3212–3216 of the Revised Statutes, and also Regulations No. 2 (revised) and Regulations No. 12 (revised).

ART. 1009. **Collection of tax by distraint.**—If any person liable to pay any taxes neglects or refuses to pay them within ten days after notice and demand, it shall be lawful for the collector or his deputy to collect such taxes with 5 per cent additional and interest at 12 per cent per annum by distraint and sale of the goods, chattels or effects, including stocks, securities, and evidences of debt, of the person delinquent. When goods, chattels, or effects sufficient to satisfy the taxes imposed upon any person are not found by the collector or deputy collector, he is authorized to collect such taxes by seizure and sale of real estate. See further sections 3186 (as amended by the Act of March 4, 1913), 3187–3196, 3197 (as amended by the Act of March 1, 1879), 3198–3202, 3203 (as amended by the Act of March 1, 1879), 3204–3207, 3208 (as amended by the Act of March 1, 1879) and 3209 of the Revised Statutes and Regulations No. 12 (revised). Distraint may also be used against a delinquent collector. See section 3217 of the Revised Statutes.

ART. 1010. **Enforcement of tax lien by bill in equity.**—In any case where there has been refusal or neglect to pay the tax and it has become necessary to seize and sell real estate to satisfy it, a bill in equity may be filed in a district court of the United States to enforce the lien of the United States for tax upon any real estate in which the delinquent has any right, title or interest. This remedy does not supersede distraint, but is cumulative. In the event of nonpayment of a tax after demand it becomes a lien in favor of the United States from the time when the assessment list was received by the collector upon all property and rights to property belonging to the taxpayer, except that the lien is not valid as against any mortgagee, purchaser or judgment creditor until notice thereof is filed in the proper public office or offices on form 668. See sections 3186 (as amended by the Act of March 4, 1913) and 3207 of the Revised Statutes and Regulations No. 12 (revised).

ART. 1011. **Compromise of tax cases.**—The Commissioner, with the advice and consent of the Secretary of the Treasury, may compromise any civil or criminal case arising under the internal revenue laws instead of commencing suit thereon, and with the advice and consent of the Secretary and the recommendation of the Attorney General may compromise any such case after suit thereon has been commenced by the United States. Accordingly, the power to compromise extends to (*a*) both civil and criminal cases; (*b*) cases whether before or after suit; and (*c*) both taxes and penalties, except that taxes legally due from a solvent taxpayer may not be compromised. Refunds can not be made of accepted offers in compromise in cases where it is subsequently ascertained that no violation of law was involved. See further sections 3229 and 3469, and sections 5292 and 5293 (as amended by the Act of February 27, 1877), of the Revised Statutes.

ART. 1012. **Assessment of tax.**—When the returns are received at the collectors' offices, they are examined and listed before being forwarded to the Commissioner. If it appears that the tax is greater or less than shown in the return, it is recomputed. After checking the figures the Commissioner assesses the tax on the basis of the collectors' lists. The collectors then send out bills for the taxes, either as computed by the taxpayer or as recomputed. If a taxpayer believes that he has been overassessed, he may file a claim for abatement or (after payment of the tax) for a refund of the excess. See section 252 of the statute and articles 1031–1038. As soon as practicable the returns are carefully audited by accountants in the office of the Commissioner at Washington, assisted where necessary by reports of the examination of taxpayers' books and records made by revenue agents in the field. If error in a return is detected, the taxpayer is notified accordingly and an additional assessment is made against him or he is given the opportunity to file a claim for a refund, as the case may be. Any assessment must be made within five years after the return was due or was made, except in the case of false or fraudulent returns with intent to evade the tax. See sections 228, 1305 and 1318 of the statute and articles 451 and 1711.

ART. 1013. **Declaration of termination of taxable period.**—In the case of a taxpayer who designs by immediate departure from the country or otherwise to avoid payment of the tax for the preceding or current taxable year, the Commissioner may so find upon evidence satisfactory to him and may declare the taxable period for such taxpayer terminated at the end of the month last past, causing the service upon him of a notice and demand for immediate payment of the tax declared due and any other tax unpaid. In such a case the taxpayer is entitled to a full personal exemption and credit for dependents, if otherwise allowable. See section 216 of the statute and article 305. If suit is necessary to collect the tax, the Commissioner's finding is presumptive evidence of the taxpayer's design. A taxpayer who is not in default in making returns or in paying other taxes may procure the postponement until the usual time of the payment of taxes declared or declarable to be due pursuant to this article by depositing with the Commissioner United States bonds of a principal amount double the estimated amount of taxes due from such person for the taxable year or by furnishing such other security as may be approved by the Commissioner. See section 1320.

RECEIPTS FOR TAXES.

SEC. 251. That every collector to whom any payment of any tax is made under the provisions of this title shall upon request give to the person making such payment a full written or printed receipt, stating the amount paid and the particular account for which such payment was made; and whenever any debtor pays taxes on account of payments made or to be made by him to separate creditors the collector shall, if requested by such debtor, give a separate receipt for the tax paid on account of each creditor in such form that the debtor can conveniently produce such receipts separately to his several creditors in satisfaction of their respective demands up to the amounts stated in the receipts; and such receipt shall be sufficient evidence in favor of such debtor to justify him in withholding from his next payment to his creditor the amount therein stated; but the creditor may, upon giving to his debtor a full written receipt acknowledging the payment to him of any sum actually paid and accepting the amount of tax paid as aforesaid (specifying the same) as a further satisfaction of the debt to that amount, require the surrender to him of such collector's receipt.

ART. 1021. **Receipts for tax payments.**—Upon request a collector will give a receipt for each tax payment. In the case of payments made by check or money order the cancelled check or the money order receipt is usually a sufficient receipt. In the case of payments in cash, however, the taxpayer should in every instance require and the collector should furnish a receipt.

REFUNDS.

SEC. 252. That if, upon examination of any return of income made pursuant to this Act, the Act of August 5, 1909, entitled "An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," the Act of October 3, 1913, entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," the Revenue Act of 1916, as amended, or the Revenue Act of 1917, it appears that an amount of income, war-profits or excess-profits tax has been paid in excess of that properly due, then, notwithstanding the provisions of section 3228 of the Revised Statutes, the amount of the excess shall be credited against any income, war-profits or excess-profits taxes, or installment thereof, then due from the taxpayer under any other return, and any balance of such excess shall be immediately refunded to the taxpayer: *Provided*, That no such credit or refund shall be allowed or made after five years from the date when the return was due, unless before the expiration of such five years a claim therefor is filed by the taxpayer.

ART. 1031. **Authority for abatement, credit, and refund of taxes.**—Authority for the credit, refund or abatement of taxes erroneously collected or assessed is contained in section 252 of the statute and in section 3220 of the Revised Statutes, as amended by section 1316 of the Revenue Act of 1918, which provides:

SEC. 3220. The Commissioner of Internal Revenue, subject to regulations prescribed by the Secretary of the Treasury, is authorized to remit, refund, and pay back all taxes erroneously or illegally assessed or collected, all penalties collected without authority, and all taxes that appear to be unjustly assessed or excessive in amount, or in any manner wrongfully collected; also to repay to any collector or deputy collector the full amount of such sums of money as may be recovered against him in any court, for any internal revenue taxes collected by him, with the cost and expenses of suit; also all damages and costs recovered against any assessor, assistant assessor, collector, deputy collector, agent, or inspector, in any suit brought against him by reason of anything done in the due performance of his official duty, and shall make report to Congress at the beginning of each regular session of Congress of all transactions under this section.

Section 3225 of the Revised Statutes, as amended by section 1316 of the Revenue Act of 1918, however, provides:

SEC. 3225. When a second assessment is made in case of any list, statement or return, which in the opinion of the collector or deputy collector was false or fraudulent, or contained any understatement or undervaluation, such assessment shall not be remitted, nor shall taxes collected under such assessment be refunded, or paid back, or recovered by any suit, unless it is proved that such list, statement, or return was not willfully false or fraudulent and did not contain any willful understatement or undervaluation.

Authority for the abatement of uncollectible taxes due from persons absconded or insolvent is contained in section 3218 of the Revised

Statutes. These provisions apply to the income and war profits and excess profits taxes imposed by the present statute and also to the excise tax under the Act of 1909, the income tax under the Acts of 1913 and 1916, and the income and excess profits taxes under the Act of 1917.

ART. 1032. **Claims for abatement of taxes erroneously assessed.**—Claims by the taxpayer for the abatement of taxes or penalties erroneously or illegally assessed or abatable under remedial acts shall be made on form 47 (revised). They must be sustained by the affidavits of the parties against whom the taxes were assessed, or of other parties cognizant of the facts. When a tax has been assessed and turned over to the collector, the presumption is that the assessment is correct. The burden of proof in rebutting the presumption and showing that it was improperly or illegally assessed, or that relief should be given under a remedial statute, rests upon the applicant for abatement. The affidavits must therefore contain full and explicit statements of all the material facts relating to the claim in support of which they are offered and to the proper consideration of which they are essential. The legality of the claim is to be determined by the Commissioner upon the facts presented by the affidavits. The filing of a claim for abatement does not necessarily operate as a suspension of the collection of the tax or make it any less the duty of the collector to exercise due diligence to prevent the collection of the tax being jeopardized. He should, if he considers it necessary, collect the tax and leave the taxpayer to his remedy by a claim for refund. See further Regulations No. 14 (revised). A collector may himself present once a month a blanket claim on form 47 (revised) for the abatement of taxes coming within certain classes of taxes erroneously assessed.

ART. 1033. **Claims for abatement of uncollectible taxes.**—When a tax is found to be uncollectible, the collector or deputy collector who made the demand for payment and is conversant with the facts may prepare a claim for abatement on form 53. See Regulations No. 14 (revised). Although credits allowed on account of insolvency or absconding release the collector from the obligation created by his receipt for the amount credited, the obligation to pay still remains upon the person assessed. It is the duty of the collector to use the same diligence to collect a tax after it has been abated as uncollectible as before abatement. Collectors should therefore keep a record of all taxes thus credited and of the persons from whom they are due, and should enforce payment whenever it is in their power to do so.

ART. 1034. **Claims for credit of taxes erroneously collected.**—Any amount of income, war profits or excess profits tax paid in excess of that properly due shall be credited against any such taxes due from the taxpayer under any other return. To obtain such credit the taxpayer should proceed as follows:

(1) Where the credit demanded is equal to or less than any outstanding assessment of tax, a taxpayer desiring to obtain such credit shall file with the collector for the district in which his original return was filed a claim on form 47 A, which shall be sworn to and shall contain the following statements: (*a*) business engaged in by claimant; (*b*) character of assessment; (*c*) amount of tax paid and for what taxable year; (*d*) portion of tax under (*c*) claimed as a credit; (*e*) unpaid assessment against which credit is asked and for what taxable year; and (*f*) all facts regarding the overpayment.

(2) Where the amount claimed as a credit is greater than the outstanding assessment of tax, a taxpayer desiring to obtain such credit and the refund to which he is entitled shall file, in addition to the claim for credit required to be made on form 47 A for the amount of the outstanding assessment, a claim for refund of the overpayment in excess of the credit. See article 1036. This claim for refund may be attached to the claim for credit or it may be separately filed with the Commissioner. All the facts regarding the total overpayment should be stated in the claim for refund and a reference made to such claim in the claim for credit.

ART. 1035. **Action on claims for credit.**—Upon receipt of a claim for credit on form 47 A the collector shall certify thereon the required information concerning all outstanding assessments and payments covered thereby and shall note on his records that a claim for credit has been filed. He shall thereupon transmit the claim to the Commissioner. Due notice will be given the collector and the taxpayer of the action taken on the claim. A schedule of credit claims on form 7220 A will be transmitted to the collector once a month and formal credit shall be taken by the collector at that time. If a claim is allowed against additional taxes due for other years, but such other taxes have not yet been assessed, only the amount of the excess of such taxes over the overpayment shall be assessed, or the excess of the overpayment over such other taxes due shall be refunded, as the case may be. A taxpayer desiring to convert a claim for refund previously filed into a claim for credit may file with the collector a claim on form 47 A, referring in it to such claim for refund. Upon its receipt by the Commissioner the claim for credit will be attached to the claim for refund and will be adjusted in the same manner as if the taxpayer had originally filed the claim for credit. The effective date of filing of the claim for credit shall be the actual date of filing such claim with the collector. The filing of a claim for credit against a tax due under another return shall be subject to the same rules with respect to the addition of interest and penalties as if the taxpayer had filed a claim for abatement of the tax against which credit is desired. See articles 1003 and 1006.

ART. 1036. **Claims for refund of taxes erroneously collected.**—Claims by the taxpayer for the refunding of taxes and penalties erroneously or illegally collected shall be made on form 46 (revised). In this case, as in that of claims for abatement, the burden of proof rests upon the claimant. All the facts relied upon in support of the claim should be clearly set forth under oath. It should be accompanied by the collector's receipt or the cancelled check showing payment of the tax. In the case of a taxpayer's death, certified copies of the letters of administration or letters testamentary, or other similar evidence, should be annexed to the claim to show the authority of the administrator or executor. The affidavit may be made by an agent of the person assessed, but in such a case a power of attorney must accompany the claim. Warrants in payment of claims allowed will be drawn in the names of the persons entitled to the money and shall unless otherwise directed be sent by the Treasurer of the United States directly to the proper persons or their duly authorized attorneys or agents. See further Regulations No. 14 (revised). In certain cases of overpayment by taxpayers the collector may repay the excess after allowance by the Commissioner of a claim for refund made by the collector on form 751. The cases in which refund is made through collectors are covered by specific provisions not herein incorporated. The Commissioner has no authority to refund on equitable grounds penalties legally collected.

ART. 1037. **Suits for recovery of taxes erroneously collected.**—No suit shall be maintained in any court for the recovery of any tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, until an appeal by a claim for credit or refund shall have been duly made to the Commissioner and a decision of the Commissioner has been had therein, unless such decision is delayed more than six months. The cause of action accrues upon an unfavorable decision by the Commissioner or at the expiration of six months after an appeal without action thereon, and no suit may be brought after two years from the time the cause of action accrued. No suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court. "Restraining" is used in its broad popular sense of hindering or impeding, as well as prohibiting or staying, and the provision is not limited in its application to suits for injunctive relief. The prohibition of such suits cannot be waived by any officer of the Government. See sections 3224, 3225 (as amended by the Revenue Act of 1918), 3226 (as amended by the Act of February 27, 1877) and 3227 of the Revised Statutes.

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ART. 1038. **Claims for refund of sums recovered by suit.**—(*a*) Claims by taxpayers for the amount of a judgment representing taxes or penalties erroneously collected should be made on form 46 (revised). The claimant should state the grounds of his claim under oath, giving the names of all the parties to the suit, the cause of action, the date of its commencement, the date of the judgment, the court in which it was recovered, and its amount. To this affidavit there should be annexed a certified copy of the final judgment, a certificate of probable cause, and an itemized bill of the costs paid receipted by the clerk or other proper officer of the court, together with a certified copy of the docket entries of the court in the case or so much thereof as may be required by the Commissioner. When a recovery is had in any suit or proceeding against a collector or other officer of the revenue for any act done by him, or for the recovery of any money exacted by or paid to him and by him paid into the Treasury, in the performance of his official duty, and the court certifies that there was probable cause for the act done by the collector or other officer, or that he acted under the directions of the Secretary of the Treasury, or other proper officer of the Government, no execution shall issue against such collector or other officer, but the amount so recovered shall, upon final judgment, be provided for and paid out of the proper appropriation from the Treasury. See section 989 of the Revised Statutes. (*b*) If the judgment debtor shall have already paid the amount recovered against him, the claim should be made in his name. There should also be a certificate of the clerk of the court in which the judgment was recovered (or other satisfactory evidence), showing that the judgment has been satisfied and specifying the exact sum paid in its satisfaction, with a detail of all items of costs which were paid by the judgment debtor or for which he is liable. See further article 1031 and Regulations No. 14 (revised).

PENALTIES.

SEC. 253. That any individual, corporation, or partnership required under this title to pay or collect any tax, to make a return or to supply information, who fails to pay or collect such tax, to make such return, or to supply such information at the time or times required under this title, shall be liable to a penalty of not more than $1,000. Any individual, corporation, or partnership, or any officer or employee of any corporation or member or employee of a partnership, who willfully refuses to pay or collect such tax, to make such return, or to supply such information at the time or times required under this title, or who willfully attempts in any manner to defeat or evade the tax imposed by this title, shall be guilty of a misdemeanor and shall be fined not more than $10,000 or imprisoned for not more than one year, or both, together with the costs of prosecution.

ART. 1041. **Specific penalties.**—A penalty of not more than $1,000 attaches for failure punctually to make a required return, whether of income, withholding or information, or to pay or collect a required tax. If the failure is willful, however, or an attempt is made to defeat or evade the tax, the offender is liable to imprisonment and to a fine of not more than $10,000 and costs. See also the Act of July 5, 1884. In addition to these specific penalties ad valorem penalties are imposed in various cases. An ad valorem penalty is assessed and collected as a part of the tax, while a specific penalty is recoverable only by suit. See section 250 of the statute and articles 1004, 1005, and 1006.

RETURNS OF PAYMENTS OF DIVIDENDS.

Sec. 254. That every corporation subject to the tax imposed by this title and every personal service corporation shall, when required by the Commissioner, render a correct return duly verified under oath, of its payments of dividends, stating the name and address of each stockholder, the number of shares owned by him, and the amount of dividends paid to him.

Art. 1051. **Return of information as to payments of dividends.**—When directed by the Commissioner, either specially or by general regulation, every domestic or resident foreign corporation and every personal service corporation shall render a return on form 1097 of its payments of dividends and distributions to stockholders for such period as may be specified, stating the name and address of each stockholder, the number and class of shares owned by him, the date and amount of each dividend paid him, and when the surplus out of which it was paid was accumulated.

RETURNS OF BROKERS.

Sec. 255. That every individual, corporation, or partnership doing business as a broker shall, when required by the Commissioner, render a correct return duly verified under oath, under such rules and regulations as the Commissioner, with the approval of the Secretary, may prescribe, showing the names of customers for whom such individual, corporation, or partnership has transacted any business, with such details as to the profits, losses, or other information which the Commissioner may require, as to each of such customers, as will enable the Commissioner to determine whether all income tax due on profits or gains of such customers has been paid.

Art. 1061. **Return of information by brokers.**—When directed by the Commissioner, either specially or by general regulation, every person doing business as a broker shall render a return on form 1100, showing the names and addresses of customers to whom payments were made or for whom business was transacted during the calendar year or other specified period next preceding and giving the other information called for by the form.

INFORMATION AT SOURCE.

SEC. 256. That all individuals, corporations, and partnerships, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, and employers, making payment to another individual, corporation, or partnership, of interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income (other than payments described in sections 254 and 255), of $1,000 or more in any taxable year, or, in the case of such payments made by the United States, the officers or employees of the United States having information as to such payments and required to make returns in regard thereto by the regulations hereinafter provided for, shall render a true and accurate return to the Commissioner, under such regulations and in such form and manner and to such extent as may be prescribed by him with the approval of the Secretary, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment.

Such returns may be required, regardless of amounts, (1) in the case of payments of interest upon bonds, mortgages, deeds of trust, or other similar obligations of corporations, and (2) in the case of collections of items (not payable in the United States) of interest upon the bonds of foreign countries and interest upon the bonds of and dividends from foreign corporations by individuals, corporations, or partnerships, undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange.

When necessary to make effective the provisions of this section the name and address of the recipient of income shall be furnished upon demand of the individual, corporation, or partnership paying the income.

The provisions of this section shall apply to the calendar year 1918 and each calendar year thereafter, but shall not apply to the payment of interest on obligations of the United States.

ART. 1071. **Return of information as to payments of $1,000.**—All persons making payment to another person of fixed or determinable income of $1,000 or more in a taxable year must render a return thereof to the Commissioner for the preceding calendar year on or before March 15 of each year, except as specified in articles 1073, 1074, 1075, 1076, and 1079. The return shall be made in each case on form 1099 (revised), accompanied by a letter of transmittal on form 1096 (revised) showing the number of returns filed and the aggregate amount represented by the payments. The street and number where the recipient of the payment lives should be stated, if possible. Where no present address is available, the last known post-office address must be given. Although to make necessary a return of information the income must be fixed or determinable, it need not be annual or periodical. See article 362.

ART. 1072. **Return of information as to payments to employees.**—The names of all employees to whom payments exceeding $1,000 a year are made, whether such total sum is made up of wages, salaries, commissions, or compensation in any other form, must be reported. Heads of branch offices and subcontractors employing labor, who keep the only complete record of payments therefor, should file returns of information in regard to such payments directly with the Commissioner. When both main office and branch office have adequate records, the return should be filed by the main office. In the case of an employer having a large number of employees who are moved from place to place as the exigencies of the service require, and who consequently has no complete record of annual payments to them at any one place, the salary of two representative months may be taken to establish a fair monthly wage, and unless the yearly payment based on this estimate in the case of an employee amounts to $1,000 or more, no return of payments to such employee is required. See articles 32–34.

Art. 1073. **Return of information by partnerships, personal service corporations, and fiduciaries.**—Partnerships and personal service corporations shall prepare reports on form 1099 (revised) for each member of the partnership or personal service corporation, and fiduciaries shall prepare such reports for each beneficiary of the estate or trust, showing in every case the distributive shares of the members or beneficiaries, whether or not actually distributed.

Art. 1074. **Cases where no return of information required.**—Payments of the following character, although over $1,000, need not be reported in returns of information on form 1099 (revised): (*a*) payments of interest on obligations of the United States; (*b*) dividends paid by domestic or resident foreign corporations (other than distributions by personal service corporations); (*c*) payments by a broker to his customers; (*d*) payments made to corporations; (*e*) bills paid for merchandise, telegrams, telephone, freight, storage, and similar charges; (*f*) payments to employees for board and lodging while traveling in the course of their employment; (*g*) annuities representing the return of capital; (*h*) payments of rent made to real estate agents (but the agent must report payments to the landlord if they amount to $1,000 or more annually); (*i*) payments made by branches of business houses located in foreign countries to alien employees serving in foreign countries; and (*j*) payments made by the United States Government to sailors and soldiers and to its civilian employees.

Art. 1075. **Return of information as to interest on corporate bonds.**—In the case of payments of interest, regardless of amount, upon bonds and similar obligations of domestic or resident foreign corporations, the original ownership certificates, when duly filed, shall constitute and be treated as returns of information. If a bondholder files no ownership certificate in the case of payments of interest on registered bonds, the withholding agent shall make out such a certificate in each instance and file it with his monthly return. See sections 221 and 237 of the statute and articles 361–376.

ART. 1076. **Return of information as to payments to nonresident aliens.**—In the case of payments of annual or periodical income to nonresident alien individuals, or to foreign corporations not engaged in trade or business within the United States and not having any office or place of business therein, the returns by withholding agents on forms 1098 (revised) and 1042 (revised) shall constitute and be treated as returns of information. See sections 221 and 237 of the statute and articles 361–376.

ART. 1077. **Source of information as to foreign items.**—The term "foreign item," as here used, means any dividend upon the stock of a nonresident foreign corporation or any item of interest upon the bonds of foreign countries or nonresident foreign corporations, whether or not such dividend or interest is paid in the United States or by check drawn on a domestic bank. (*a*) Wherever a foreign country or nonresident foreign corporation issuing bonds has appointed a paying agent in this country, charged with the duty of paying the interest upon such bonds, such paying agent shall be the source of information. If such foreign country or foreign corporation has no such agent, then the last bank or collecting agent in this country shall be the source of information. (*b*) In the case of dividends on the stock of a nonresident foreign corporation, however, the first bank or collecting agent accepting such item for collection shall be the source of information.

ART. 1078. **Ownership certificates for foreign items.**—(*a*) When bonds of foreign countries, or bonds or stocks of nonresident foreign corporations, are owned by citizens or residents of the United States, individual or fiduciary, or by domestic or resident foreign corporations or partnerships, ownership certificate form 1001 A (revised) shall be executed by the actual owner or by his duly authorized agent when presenting the item for collection, whether such item is a dividend or an interest payment, except in the case of a foreign country or a foreign corporation having a fiscal agent or a paying agent in this country and issuing bonds which contain a tax-free covenant clause. In such excepted case the fiscal agent or a paying agent is required to withhold a tax of 2 per cent from the interest on such bonds and ownership certificate form 1000 (revised), modified to show the name and address of the fiscal agent or the paying agent, should be used, unless the owner (if so entitled) desires to claim exemption, in which case form 1001 A (revised) should be filed. (*b*) Where such foreign bonds or stocks are owned by nonresident alien individuals, corporations or partnerships, ownership certificate form

1001 A (revised) shall be used on behalf of such owner by any responsible bank or banker, either foreign or domestic, having knowledge of such ownership. In such a case the bank or banker need not fill in the names of the owners. See article 361.

ART. 1078(a). **Foreign items presented for collection unaccompanied by ownership certificates.**—If the foreign item is an interest coupon detached from bonds containing a tax-free covenant clause, issued by a foreign country or corporation having a paying agent in the United States, an affidavit and ownership certificate, form 1000 (revised), shall be furnished as provided in article 368.

In the case of other foreign items which are received unaccompanied by an ownership certificate and the owner is unknown, an affidavit shall be required of the payee, showing the name and address of the payee, the name and address of the debtor organization, the date of the dividend check or the maturity of the interest coupon, the name and address of the person from whom the dividend check or interest coupon was received, and a statement that the owner of the securities is unknown to the payee. The first bank receiving such foreign item shall prepare a certificate of ownership, form 1001 A (revised), crossing out the word "owner" and substituting therefor the word "payee." The first bank shall stamp or write across the face of the certificate "affidavit furnished," adding the name of the bank. Thereupon the affidavit and certificate shall be forwarded to the Commissioner as provided in article 1079.

ART. 1079. **Return of information as to foreign items.**—In the case of collections of foreign items, regardless of amount, the original ownership certificates, when duly filed, shall constitute and be treated as returns of information. (*a*) In the case of dividends, as to which the first bank or collecting agent is the source of information, it shall detach the ownership certificate and indorse on the item the words, "Certificate detached and information furnished," adding its name and address. When foreign items have been indorsed as above prescribed, the certificates shall be forwarded to the Commissioner on or before the 20th day of the month following that during which the items were accepted, accompanied by a return on form 1096 A showing the number of certificates and the aggregate amount of foreign items disclosed thereon. An annual return on form 1096 B shall be forwarded to the Commissioner not later than March 15 of each year, on which shall be given a summary of the monthly returns. (*b*) In the case of interest items, as to which the paying agent or the last bank or collecting agent in this country is the source of information, the ownership certificate shall accompany the coupon to such agent or source of information, who shall forward the ownership certificate to the Commissioner in the same manner as above provided with respect to dividend items. Where ownership certificate form 1000 (revised) is used, a monthly return shall be made on form 1012 (revised) and an annual return on form 1013 (revised), as provided in articles 361–376. Forms 1012 (revised) and 1013 (revised), when so used, should be modified to show the name and address of the paying agent. The use of substitute certificates is not permitted in the collection of foreign items.

ART. 1080. **Information as to actual owner.**—When the person receiving a payment falling within the provisions of the statute for information at the source is not the actual owner of the income received, the name and address of the actual owner shall be furnished upon demand of the individual, corporation or partnership paying the income, and in default of a compliance with such demand the payee becomes liable to the penalties provided. See section 253 of the statute and article 1041.

RETURNS TO BE PUBLIC RECORDS.

SEC. 257. That returns upon which the tax has been determined by the Commissioner shall constitute public records; but they shall be open to inspection only upon order of the President and under rules and regulations prescribed by the Secretary and approved by the President: *Provided,* That the proper officers of any State imposing an income tax may, upon the request of the governor thereof, have access to the returns of any corporation, or to an abstract thereof showing the name and income of the corporation, at such times and in such manner as the Secretary may prescribe: *Provided further,* That all bona fide stockholders of record owning 1 per centum or more of the outstanding stock of any corporation shall, upon making request of the Commissioner, be allowed to examine the annual income returns of such corporation and of its subsidiaries. Any stockholder who pursuant to the provisions of this section is allowed to examine the return of any corporation, and who makes known in any manner whatever not provided by law the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any such return, shall be guilty of a misdemeanor and be punished by a fine not exceeding $1,000, or by imprisonment not exceeding one year, or both.

The Commissioner shall as soon as practicable in each year cause to be prepared and made available to public inspection in such manner as he may determine, in the office of the collector in each internal-revenue district and in such other places as he may determine, lists containing the names and the post-office addresses of all individuals making income-tax returns in such district.

ART. 1091. **Inspection of returns.**—The returns upon which the tax has been determined by the Commissioner, although public records, are open to inspection only to the extent authorized by the President, except as otherwise expressly provided. The President, by an executive order dated January 7, 1920, directed that returns of income should be subject to inspection in accordance with the following regulations prescribed by the Secretary of the Treasury:

1. These regulations deal only with *inspection* of returns, as the statutes expressly require the approval of the President of regulations on this subject. Other uses to which returns may be lawfully put, without action by the President, are not covered by these regulations.

2. The word "corporation" when used alone herein shall, unless otherwise indicated, include corporations, associations, joint-stock companies, and insurance companies. The word "return" when so used, shall, unless otherwise indicated, include income and profits tax returns; and also special excise tax returns of corporations filed pursuant to section 1000, Title X, of the Revenue Act of 1918.

3. Written statements filed with the Commissioner of Internal Revenue designed to be supplemental to and to become a part of tax returns shall be subject to the same rules and regulations as to inspection as are the tax returns themselves.

4. Except as hereinafter specifically provided, the Commissioner of Internal Revenue may, in his discretion, upon written application setting forth fully the reasons for the request, grant permission for the inspection of returns in accordance with these regulations. The application will be considered by the Commissioner and a decision reached by him whether the applicant has met the conditions imposed by these regulations and whether the reasons advanced for permission to inspect are sufficient to permit the inspection. Such written application is not required of the officers and employees of the Treasury Department whose official duties require inspection of a return, or of the Solicitor of Internal Revenue.

5. The return of an individual shall be open to inspection as follows:

(*a*) By the officers and employees of the Treasury Department whose official duties require such inspection and by the Solicitor of Internal Revenue; (*b*) by the person who made the return, or by his duly constituted attorney in fact; (*c*) by the administrator, executor, or trustee of the taxpayer's estate, or by the duly constituted attorney in fact of such administrator, executor, or trustee, where the maker of the return has died; and (*d*) in the discretion of the Commissioner of Internal Revenue, by one of the heirs at law or next of kin of such deceased person upon showing that he has a material interest which will be affected by information contained in the return.

6. A joint return of a husband and wife shall be open to inspection (*a*) by the officers and employees of the Treasury Department whose official duties require such inspection and by the Solicitor of Internal Revenue; and (*b*) by either spouse for whom the return was made, or his or her duly constituted attorney, upon satisfactory evidence of such relationship being furnished.

7. The return of a partnership shall be open to inspection (*a*) by the officers and employees of the Treasury Department whose official duties require such inspection and by the Solicitor of Internal Revenue; and (*b*) by any individual (or his duly constituted attorney in fact or legal representative) who was a member of such partnership during any part of the time covered by the return, upon satisfactory evidence of such fact being furnished.

8. The return of a corporation shall be open to inspection (*a*) by the officers and employees of the Treasury Department whose official duties require such inspection and by the Solicitor of Internal Revenue; (*b*) upon satisfactory evidence of identity and official position, by the president, vice president, secretary or treasurer of such corporation, or, if none, its principal officer; and (*c*) by a stockholder of such corporation as provided in paragraph 9 hereof.

9. A stockholder of record owning 1 per cent or more of the stock of the outstanding stock of a corporation may be permitted to inspect its return. Such permission will only be granted upon an application in writing to the Commissioner of Internal Revenue accompanied by an affidavit showing applicant's address, the name of the corporation, the period of time covered by the return he desires to inspect, and a certificate from the officials of the corporation, or other satisfactory evidence showing the amount of the corporation's outstanding capital stock, the number of shares owned by the applicant, the date when such stock was acquired, and satisfactory proof of identity. This privilege of inspection is personal and will be granted only to the stockholder. This rule has no application to the return of a corporation filed pursuant to the Revenue Act of 1918, specific provision, independent of presidential regulation, being made in that act for inspection by a stockholder of a return of a corporation filed thereunder (second proviso of sec. 257).

10. When the head of an executive department (other than the Treasury Department) or of any other United States Government establishment desires to inspect or to have some other officer or employee of his branch of the service inspect a return in connection with some matter officially before him, the inspection may, in the discretion of the Secretary of the Treasury, be permitted upon written application to him by the head of such executive department or other Government establishment. The application must be signed by such head and must show in detail why the inspection is desired, the name and address of the taxpayer who made the return, and the name and official designation of the one it is desired shall inspect the return. When the head of a bureau or office in the Treasury Department, not a part of the Internal Revenue Bureau, desires to inspect a return in connection with some matter officially before him, other than an income, profits tax, or corporation excise tax matter, the inspection may, in the discretion of the Secretary, be permitted upon written application to him by the head of such bureau or office, showing in detail why the inspection is desired. The reasons submitted for permission to inspect as provided in this paragraph shall be considered by the Secretary and a decision reached by him whether the reasons are sufficient to permit the inspection.

11. When it becomes necessary for the department to furnish returns or copies thereof for use in legal proceedings, inspection of such returns or copies that necessarily results from such use is permitted.

12. Except as provided in paragraph 11, returns may be inspected only in the office of the Commissioner of Internal Revenue, Washington, District of Columbia.

13. A person who, under these regulations, is permitted to inspect a return may make and take copy thereof or a memorandum of data contained therein.

14. By section 3167, Revised Statutes, as amended by the Revenue Act of 1918, it is made a misdemeanor for any person to print or publish in any manner whatever not provided by law any income return, or any part thereof, or source of income, profits, losses, or expenditures appearing in any income return, which misdemeanor is punishable by a fine not exceeding $1,000 or by imprisonment not exceeding one year, or both, at the discretion of the court; and if the offender be an officer or employee of the United States, by dismissal from office or discharge from employment.

15. All former regulations bearing on the subject of inspection of returns are hereby superseded.

16. These regulations shall remain in force until expressly withdrawn or overruled.

Art. 1091(a). **Furnishing of copies of income returns.**—1. The original income return of an individual, partnership, corporation, association, joint-stock company, insurance company, or fiduciary, or a copy thereof, may be furnished by the Commissioner of Internal Revenue to a United States attorney for use as evidence before a United States grand jury or in litigation in any court, where the United States is interested in the result, or for use in the preparation for such litigation, or to an attorney connected with the Department of Justice designated by the Attorney General to handle such matters, if and when the Attorney General states to the Commissioner in writing that such attorney is so designated. When an income return or copy thereof is thus furnished, it must be limited in use to the purpose for which it is furnished and is under no conditions to be made public except where publicity necessarily results from such use. In case the original return is necessary, it shall be placed in evidence by the Commissioner of Internal Revenue or by some other officer or employee of the Internal Revenue Bureau designated by the Commissioner for that purpose, and after it has been placed in evidence it shall be returned to the files in the office of the Commissioner in Washington. An original return will be furnished only in exceptional cases, and then only when it is made to appear that the ends of justice may otherwise be defeated. Neither the original nor a copy of an income return desired for use in litigation in court where the United States Government is not interested in the result and where such use might result in making public the information contained therein will be furnished, except as otherwise provided in the next succeeding paragraph.

2. A copy of an income return may be furnished by the Commissioner of Internal Revenue to the person who made the return or to his duly constituted attorney, or if the person is deceased, to his executor or administrator; or if the entity is in the hands of a receiver, trustee in bankruptcy, guardian, or similar legal custodian, to the receiver, trustee, or other similar custodian upon written application for same, accompanied by satisfactory evidence that the applicant comes within this provision. "The person who made the return," as herein used, refers in the case of an individual return to the individual whose return is desired, and in the case of a return of a corporation, association, joint-stock company, insurance company, or fiduciary to the corporation, association, joint-stock company, or fiduciary, a copy of whose return is desired. A corporation may also designate by proper action of its board of directors the officer or individual to whom a copy of a return made by the corporation may be furnished, and upon sufficient evidence of such action and of the identity of the officer or individual, a copy may

be furnished to such person. A copy of a partnership income return will be furnished to the partners only in case all the partners join in the request therefor, it matters not what particular partner or officer of the partnership made the return. If the partnership has been dissolved, the members surviving may be furnished a copy if all the members surviving join in the request.

ART. 1092. **Inspection of returns by State.**—1. The proper officers of a State imposing an income tax are entitled as of right upon the request of its governor to have access to the income and profits tax returns of a corporation, association, joint-stock company, or insurance company, or to an abstract thereof, showing its name and income. Proper officers in this connection are only those officers of the State who are charged with the enforcement of the State income-tax law and who are to use the information gained by the access only in connection with such enforcement.

2. The request or application of the governor must be in writing signed by him under the seal of his State and must show:

(*a*) That the State imposes an income tax.

(*b*) The name and address of the corporation, association, joint-stock company, or insurance company making the returns to which access is desired.

(*c*) Why access is desired.

(*d*) The names and official positions of the officers designated to have the access.

(*e*) That such designated officers are charged with the enforcement of the State income-tax law.

(*f*) That the information to be gained by the access is to be used only in connection with such enforcement.

3. The request or application of the governor may be addressed either to the Secretary of the Treasury or to the Commissioner of Internal Revenue, but should be transmitted to the Commissioner, who will set a convenient time for the access to the returns (or to an abstract thereof as he may determine).

4. Access shall be given only in the office of the Commissioner of Internal Revenue in Washington.

5. The officers designated by the governor will not be permitted to name another person or persons to examine the returns (or abstracts) for them.

6. The officers designated will be given access only to the returns of those corporations, associations, joint-stock companies, or insurance companies organized or doing business in their State.

7. The officers designated may have access to lists furnished to supplement and become a part of the returns to which they are given access.

8. The proper officers, as defined in paragraph 1, may have access to the capital stock tax returns filed under the provisions of section 1000 of the Revenue Act of 1918 under the same conditions prescribed in the preceding paragraph for access to the income and profits tax returns of corporations, associations, joint-stock companies, and insurance companies. This right does not extend to the examination of capital stock tax returns filed pursuant to prior acts of Congress.

ART. 1093. **Inspection of returns by stockholder.**—A bona fide stockholder of record owning 1 per cent or more of the outstanding stock of a corporation shall be entitled as of right, upon making request of the Commissioner of Internal Revenue, to examine the annual income returns of such corporation and of its subsidiaries made under Titles II and III of the Revenue Act of 1918, and all returns of corporations filed for purposes of the tax imposed by section 1000, Title X, of said act. His request for permission to examine such returns must be made in writing and must be in the form of an affidavit showing his address, the name of the corporation, the period of time covered by the return he desires to inspect, the amount of the corporation's outstanding capital stock, the number of shares owned by him, the date when he acquired them, and whether he has the beneficial as well as the record title to such shares. It must also show that he has not acquired his shares for the purpose of the examination of the income returns of the corporation. If he has acquired them for this purpose he is not a bona fide stockholder within the meaning of the statute. The application must be supported by satisfactory evidence showing that the applicant is a bona fide stockholder of record of the required amount of stock of the corporation. The supporting evidence may be partly in the form of a certificate signed by the president or vice president of the corporation, and countersigned by the secretary under the corporate seal. Upon being satisfied from the evidence presented that the applicant has fully met these conditions the Commissioner will grant the permission to examine the returns and set a convenient time for the examination in the office of the Commissioner. This privilege is personal and will be granted only to the stockholder, who can not delegate it to another.

ART. 1094. **Penalties for disclosure of returns.**—A stockholder who examines the return of a corporation and reveals without express authority of law any particulars of its income statement is guilty of a misdemeanor and liable to fine and imprisonment. Section 3167 of the Revised Statutes, as amended by section 1317 of the Revenue Act of 1918, also provides:

SEC. 3167. It shall be unlawful for any collector, deputy collector, agent, clerk, or other officer or employee of the United States to divulge or to make known in any manner whatever not provided by law to any person the operations, style of work, or apparatus of any manufacturer or producer visited by him in the discharge of his official duties, or the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any income return, or to permit any income return or copy thereof or any book containing any abstract or particulars thereof to be seen or examined by any person except as provided by law; and it shall be unlawful for any person to print or publish in any manner whatever not provided by law any income return, or any part thereof or source of income, profits, losses, or expenditures appearing in any income return; and any offense against the foregoing provision shall be a misdemeanor and be punished by a fine not exceeding $1,000 or by imprisonment not exceeding one year, or both, at the discretion of the court; and if the offender be an officer or employee of the United States he shall be dismissed from office or discharged from employment.

An internal revenue officer discovering in the course of his duty information leading him to suspect a possible violation of any law with the enforcement of which he is not directly concerned should immediately report the matter to the Commissioner, who is authorized to communicate with the proper department involved.

PUBLICATION OF STATISTICS.

SEC. 258. That the Commissioner, with the approval of the Secretary, shall prepare and publish annually statistics reasonably available with respect to the operation of the income, war-profits and excess-profits tax laws, including classifications of taxpayers and of income, the amounts allowed as deductions, exemptions, and credits, and any other facts deemed pertinent and valuable.

ART. 1101. **Statistics of income.**—The Commissioner will publish annually a volume of statistics of income, showing, among other things, the distribution of incomes between corporations and individuals and by States, by classes and by occupations.

COLLECTION OF FOREIGN ITEMS.

SEC. 259. That all individuals, corporations, or partnerships undertaking as a matter of business or for profit the collection of foreign payments of interest or dividends by means of coupons, checks, or bills of exchange shall obtain a license from the Commissioner and shall be subject to such regulations enabling the Government to obtain the information required under this title as the Commissioner, with the approval of the Secretary, shall prescribe; and whoever knowingly undertakes to collect such payments without having obtained a license therefor, or without complying with such regulations, shall be guilty of a misdemeanor and shall be fined not more than $5,000, or imprisoned for not more than one year, or both.

ART. 1111. **License to collect foreign items.**—Banks or agents collecting foreign items, as defined in article 1077, and required by article

1079 to make returns of information with respect thereto, must obtain a license from the Commissioner to engage in such business. Application form 1017 (revised) for such license may be procured from collectors. The license is issued without cost on form 1010. Foreign items shall not be accepted for collection by any bank or collecting agent so licensed unless properly indorsed or accompanied by proper ownership certificates giving all the information called for by such certificate. See section 256 and articles 1077–1079.

CITIZENS OF UNITED STATES POSSESSIONS.

SEC. 260. That any individual who is a citizen of any possession of the United States (but not otherwise a citizen of the United States) and who is not a resident of the United States, shall be subject to taxation under this title only as to income derived from sources within the United States, and in such case the tax shall be computed and paid in the same manner and subject to the same conditions as in the case of other persons who are taxable only as to income derived from such sources.

ART. 1121. **Status of citizen of United States possession.**—A citizen of a possession of the United States, who is not otherwise a citizen or a resident of the United States, including only the States, the Territories of Alaska and Hawaii, and the District of Columbia, is treated for the purpose of the tax as if he were a nonresident alien individual. See articles 91–93, 271, 306, 307, 311, 316, and 404. His income from sources within the United States is subject to withholding. See section 221 and articles 361–376.

PORTO RICO AND PHILIPPINE ISLANDS.

SEC. 261. That in Porto Rico and the Philippine Islands the income tax shall be levied, assessed, collected, and paid in accordance with the provisions of the Revenue Act of 1916 as amended.

Returns shall be made and taxes shall be paid under Title I of such Act in Porto Rico or the Philippine Islands, as the case may be, by (1) every individual who is a citizen or resident of Porto Rico or the Philippine Islands or derives income from sources therein, and (2) every corporation created or organized in Porto Rico or the Philippine Islands or deriving income from sources therein. An individual who is neither a citizen nor a resident of Porto Rico or the Philippine Islands but derives income from sources therein, shall be taxed in Porto Rico or the Philippine Islands as a nonresident alien individual, and a corporation created or organized outside Porto Rico or the Philippine Islands and deriving income from sources therein shall be taxed in Porto Rico or the Philippine Islands as a foreign corporation. For the purposes of section 216 and of paragraph (6) of subdivision (a) of section 234 a tax imposed in Porto Rico or the Philippine Islands upon the net income of a corporation shall not be deemed to be a tax under this title.

The Porto Rican or Philippine Legislature shall have power by due enactment to amend, alter, modify, or repeal the income tax laws in force in Porto Rico or the Philippine Islands, respectively.

ART. 1131. **Income tax in Porto Rico and Philippine Islands.**—The Revenue Act of 1918 is not in force in Porto Rico and the Philippine Islands. See also section 1400 of the statute. No credit against net income is allowed individuals and no deduction from gross income is allowed corporations with respect to dividends received from a foreign corporation (foreign with respect to the United States) taxed in Porto Rico or the Philippines, but having no income from sources within the United States.

ART. 1132. **Taxation of individuals between United States and Porto Rico and Philippine Islands.**—(*a*) A citizen of the United States who resides in Porto Rico, and a citizen of Porto Rico who resides in the United States, are taxable in both places, but the income tax in the United States is credited with the amount of any income, war profits, and excess profits taxes paid in Porto Rico. See section 222 of the statute and articles 381–385. (*b*) A resident of the United States, who is not a citizen of Porto Rico, is taxable in Porto Rico as a nonresident alien individual on any income derived from sources within Porto Rico, but the income tax in the United States is credited with the tax paid in Porto Rico. (*c*) A resident of Porto Rico, who is not a citizen of the United States, is taxable in the United States as a nonresident alien individual on any income derived from sources within the United States, and receives no such credit. See also section 260 and article 1121. The same principles apply in the case of the Philippine Islands.

ART. 1133. **Taxation of corporations between United States and Porto Rico and Philippine Islands.**—(*a*) A United States corporation which derives income from sources within Porto Rico, (*b*) a Porto Rico corporation which derives income from sources within the United States, and (*c*) a corporation of a foreign country which derives income both from sources within Porto Rico and from sources within the United States, are all taxable in both places. In the case of the United States corporation the income, war profits, and excess profits taxes in the United States are credited with the amount of any income, war profits, and excess profits taxes paid in Porto Rico. In the case of the Porto Rico corporation there is no such credit. See section 238 of the statute and article 611. The corporation of the foreign country deriving income from both places is subject to no double taxation so far as the United States and Porto Rico are concerned. For the purpose of withholding a Porto Rico corporation is a foreign corporation. See section 237 and article 601. The same principles apply in the case of the Philippine Islands.

PART IV.

DEFINITIONS AND GENERAL PROVISIONS.

GENERAL DEFINITIONS.

SECTION 1. That when used in this Act—

The term "person" includes partnerships and corporations, as well as individuals;

The term "corporation" includes associations, joint-stock companies, and insurance companies;

The term "domestic" when applied to a corporation or partnership means created or organized in the United States;

The term "foreign" when applied to a corporation or partnership means created or organized outside the United States;

The term "United States" when used in a geographical sense includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia;

The term "Secretary" means the Secretary of the Treasury;

The term "Commissioner" means the Commissioner of Internal Revenue;

The term "collector" means collector of internal revenue;

The term "Revenue Act of 1916" means the Act entitled "An Act to increase the revenue, and for other purposes," approved September 8, 1916;

The term "Revenue Act of 1917" means the Act entitled "An Act to provide revenue to defray war expenses, and for other purposes," approved October 3, 1917;

The term "taxpayer" includes any person, trust or estate subject to a tax imposed by this Act;

The term "Government contract" means (a) a contract made with the United States, or with any department, bureau, officer, commission, board, or agency, under the United States and acting in its behalf, or with any agency controlled by any of the above if the contract is for the benefit of the United States, or (b) a subcontract made with a contractor performing such a contract if the products or services to be furnished under the subcontract are for the benefit of the United States. The term "Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive" when applied to a contract of the kind referred to in clause (a) of this paragraph, includes all such contracts which, although entered into during such period, were originally not enforceable, but which have been or may become enforceable by reason of subsequent validation in pursuance of law;

The term "military or naval forces of the United States" includes the Marine Corps, the Coast Guard, the Army Nurse Corps, Female, and the Navy Nurse Corps, Female, but this shall not be deemed to exclude other units otherwise included within such term;

The term "present war" means the war in which the United States is now engaged against the German Government.

For the purposes of this Act the date of the termination of the present war shall be fixed by proclamation of the President.

ART. 1501. **Person.**—The statute recognizes three chief classes of persons, to wit, individuals, partnerships, and corporations. Corporations include associations, joint-stock companies, and insurance companies, but not partnerships properly so-called. A taxpayer is any person, trust, or estate subject to tax.

ART. 1502. **Association.**—Associations and joint-stock companies include associations, common law trusts, and organizations by whatever name known, which act or do business in an organized capacity, whether created under and pursuant to State laws, agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the members or shareholders on the basis of the capital stock which each holds or, where there is no capital stock, on the basis of the proportionate share or capital which each has or has invested in the business or property of the organization.

ART. 1503. **Association distinguished from partnership.**—An organization the membership interests in which are transferable without the consent of all the members, however the transfer may be otherwise restricted, and the business of which is conducted by trustees or directors and officers without the active participation of all the members as such, is an association and not a partnership. A partnership bank conducted like a corporation and so organized that the interests of its members may be transferred without the consent of the other members is a joint-stock company or association within the meaning of the statute. A partnership bank the interests of whose members can not be so transferred is a partnership.

ART. 1504. **Association distinguished from trust.**—Where trustees hold real estate subject to a lease and collect the rents, doing no business other than distributing the income less taxes and similar expenses to the holders of their receipt certificates, who have no control except the right of filling a vacancy among the trustees and of consenting to a modification of the terms of the trust, no association exists and the cestuis que trust are liable to tax as beneficiaries of a trust the income of which is to be distributed periodically, whether or not at regular intervals. But in such a trust if the trustees pursuant to the terms thereof have the right to hold the income for future distribution, the net income is taxed to the trustees instead of to the beneficiaries. See section 219 of the statute and articles 341–347. If, however, the cestuis que trust have a voice in the conduct of the business of the trust, whether through the right periodically to elect trustees or otherwise, the trust is an association within the meaning of the statute.

ART. 1505. **Limited partnership as partnership.**—So-called limited partnerships of the type authorized by the statutes of New York and most of the States are partnerships and not corporations within the meaning of the statute. Such limited partnerships, which can not limit the liability of the general partners, although the special partners enjoy limited liability so long as they observe the statutory conditions, which are dissolved by the death or attempted transfer of the interest of a general partner, and which can not take real estate or sue in the partnership name, are so like common law partnerships as to render impracticable any differentiation in their treatment for tax purposes. Michigan and Illinois limited partnerships are partnerships. A California special partnership is a partnership.

ART. 1506. **Limited partnership as corporation.**—On the other hand, limited partnerships of the type of partnerships with limited liability or partnership associations authorized by the statutes of Pennsylvania and of a few other States are only nominally partnerships. Such so-called limited partnerships, offering opportunity for limiting the liability of all the members, providing for the transferability of partnership shares, and capable of holding real estate and bringing suit in the common name, are more truly corporations than partnerships and must make returns of income and pay the tax as corporations. The income received by the members out of the earnings of such limited partnerships will be treated in their personal returns in the same manner as distributions on the stock of corporations. In all doubtful cases limited partnerships will be treated as corporations unless they submit satisfactory proof that they are not in effect so organized. A Michigan partnership association is a corporation. Such a corporation may or may not be a personal service corporation. See sections 200 and 218 of the statute and articles 1523–1532.

ART. 1507. **Joint ownership and joint adventure.**—Joint investment in and ownership of real and personal property not used in the operation of any trade or business and not covered by any partnership agreement does not constitute a partnership. Co-owners of oil lands engaged in the joint enterprise of developing the property through a common agent are not necessarily partners. In the absence of special facts affirmatively showing an association or partnership, where a vessel is owned by several individuals and operated by a managing owner or agent for the account of all, the relation does not constitute either a joint-stock association or a partnership. The participation of two United States corporations in a joint enterprise or adventure does not constitute them partners.

ART. 1508. **Insurance company.**—Insurance companies include both stock and mutual companies, as well as mutual benefit insurance companies. A voluntary unincorporated association of employees formed for the purpose of relieving sick and aged members and the dependents of deceased members is an insurance company, whether the fund for such purpose is created wholly by membership dues or partly by contributions from the employer. But a corporation which merely sets aside a fund for the insurance of its employees is not required to file a separate return for such fund if the income and disbursements therefrom are included in the corporation's own return. See sections 231, 233, 234, and 239 of the statute and articles 521, 548, 549, 568–572, 623, and 870.

ART. 1509. **Domestic and foreign persons.**—A domestic corporation or partnership is one organized or created in the United States, including only the States, the Territories of Alaska and Hawaii, and the District of Columbia, and a foreign corporation or partnership is one organized or created outside the United States as so defined. The nationality or residence of members of a partnership does not affect its status. A partnership created by articles entered into in San Francisco between residents of the United States and residents of China is a domestic partnership. A foreign corporation engaged in trade or business within the United States or having an office or place of business therein is sometimes referred to in the regulations as a resident foreign corporation and a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein as a nonresident foreign corporation. See also articles 4 and 312–315.

ART. 1510. **Government contract.**—Government contracts may include (*a*) a contract with the United States, (*b*) a contract with an agency of the United States, (*c*) a contract with an agency of such agency, and (*d*) a subcontract with a contractor under any such contract; provided in every case the contract or subcontract is for the benefit of the United States. Unenforceable contracts subsequently ratified are treated as though made when originally executed. The Commissioner may require any contractor to file with him copies of his Government contracts entered into on or after April 6, 1917, and shall have access to the information in the possession of the Government relating to such contracts. See section 1408 of the statute. The realization by a corporation of income from a Government contract may affect its status under the consolidated returns provision and the amount of its war profits and excess profits tax. See sections 240, 301 (c), 311 (d), 327 (d), and 200 and articles 635, 714, 719, 784, and 1524. The agreements for the operation of transportation systems while under federal control and for the just compensation of their owners made pursuant to the Act of March 21, 1918, are not Government contracts within the meaning of this article. See sections 230 and 301 (e) and article 504.

DEFINITIONS.

SEC. 200. That when used in this title—

The term "taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under section 212 or section 232. The term "fiscal year" means an accounting period of twelve months ending on the last day of any month other than December. The first taxable year, to be called the taxable year 1918, shall be the calendar year 1918 or any fiscal year ending during the calendar year 1918;

The term "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person, trust or estate;

The term "withholding agent" means any person required to deduct and withhold any tax under the provisions of section 221 or section 237;

The term "personal service corporation" means a corporation whose income is to be ascribed primarily to the activities of the principal owners or stockholders who are themselves regularly engaged in the active conduct of the affairs of the corporation and in which capital (whether invested or borrowed) is not a material income-producing factor; but does not include any foreign corporation, nor any corporation 50 per centum or more of whose gross income consists either (1) of gains, profits or income derived from trading as a principal, or (2) of gains, profits, commissions, or other income, derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive;

The term "paid," for the purposes of the deductions and credits under this title, means "paid or accrued" or "paid or incurred," and the terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212.

ART. 1521. **Fiduciary.**—"Fiduciary" is a term which applies to all persons that occupy positions of peculiar confidence toward others, such as trustees, executors, and administrators, and a fiduciary for income tax purposes is a person who holds in trust an estate to which another has the beneficial title or in which another has a beneficial interest, or receives and controls income of another as in the case of receivers. A committee of the property of an incompetent person is a fiduciary. See sections 219 and 225 of the statute and articles 341–344 and 421–425.

ART. 1522. **Fiduciary distinguished from agent.**—There may be a fiduciary relationship between an agent and a principal, but the word "agent" does not denote a fiduciary. A fiduciary relationship can not be created by a power of attorney. An agent having entire charge of property, with authority to effect and execute leases with tenants entirely on his own responsibility and without consulting his principal, merely turning over the net profits from the property periodically to his principal by virtue of authority conferred upon him by a power of attorney, is not a fiduciary within the meaning of the statute. In cases where no legal trust has been created in the estate controlled by the agent and attorney the liability to make a return rests with the principal.

ART. 1523. **Personal service corporation.**—The term "personal service corporation" means a corporation, not expressly excluded, the income of which is derived from a profession or business (*a*) which consists principally of rendering personal service, (*b*) the earnings of which are to be ascribed primarily to the activities of the principal owners or stockholders, and (*c*) in which the employment of capital is not necessary or is only incidental. No definite and conclusive tests can be prescribed by which it can be finally determined in advance of an examination of the corporation's return whether or not it is a personal service corporation. In the following articles are laid down the general principles under which such determination will be made. See also section 303 of the statute and articles 741–743.

ART. 1524. **Personal service corporation: certain corporations excluded.**—The following classes of corporations are expressly excluded from classification as personal service corporations: (*a*) foreign corporations; (*b*) corporations 50 per cent or more of whose gross income consists of gains, profits or income derived from trading as a principal; and (*c*) corporations 50 per cent or more of whose gross income consists of gains, profits, commissions or other income derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, inclusive. See article 1510. A corporation is not a personal service corporation merely because less than 50 per cent of its gross income was derived from trading as a principal or from Government contracts. A corporation can not be considered a personal service corporation when another corporation (not itself a personal service corporation) owns or controls substantially all of its stock, or when substantially all of its stock and of the stock of another corporation (not itself a personal service corporation) forming part of the same business enterprise is owned or controlled by the same interests. See section 240 of the statute and articles 631–638.

ART. 1525. **Personal services rendered by personal service corporation.**—In order that a corporation may be deemed to be a personal service corporation its earnings must be derived principally from compensation for personal services rendered by the corporation to the persons with whom it does business. Merchandising or trading either directly or indirectly in commodities or the services of others is not rendering personal service. Conducting an auction, agency, brokerage or commission business strictly on the basis of a fee or commission is rendering personal service. If, however, the corporation assumes any such risks as those of market fluctuation, bad debts, failure to accept shipments, etc., or if it guarantees the accounts of the purchaser or is in any way responsible to the seller for the payment of the purchase price, the transaction is one of merchandising or trading, and this is true even though the goods are shipped directly from the producer to the consumer and are never actually in the possession of the corporation. The fact that earnings of the corporation are termed commissions or fees is not controlling. The fact that a commission or fee is based on a difference in the prices at which the seller sells and the buyer buys raises a presumption that the transaction is one of merchandising or trading, and it will be so considered in the absence of satisfactory evidence to the contrary.

ART. 1526. **Personal services rendered by personal service corporation: more than one business.**—It frequently happens that corporations are engaged in two or more professions or businesses which are more or less related, one of which does not consist of rendering personal service. Thus an engineering concern may also engage in contracting, which amounts to trading in materials and labor, a brokerage concern may guarantee some of its accounts, a photographer may sell pictures, frames, art goods and supplies, or a dealer in a commodity may furnish expert advice or services with respect to its installation, use, etc. In such case the corporation is not a personal service corporation unless the nonpersonal service element is negligible or merely incidental and no appreciable part of its earnings are to be ascribed to such sources. See also section 303 of the statute and articles 741–743.

ART. 1527. **Activities of stockholders of personal service corporation.**—In determining whether a corporation is a personal service corporation, no weight can be given to the fact that it renders personal services unless (*a*) the principal owners or stockholders are regularly engaged in the active conduct of its affairs and are engaged in such a manner that the earnings are to be ascribed primarily to their activities, and (*b*) its affairs are conducted principally by such owners or stockholders.

ART. 1528. **Activities of stockholders of personal service corporation: conduct of affairs.**—Where the principal owners or stockholders do not render the principal part of the services, but merely supervise or direct a force of employees, the corporation is not a personal service corporation. If employees contribute substantially to the services rendered by a corporation, it is not a personal service corporation unless in every case in which services are so rendered the value of and the compensation charged for such services are to be attributed primarily to the experience or skill of the principal owners or stockholders and such fact is evidenced in some definite manner in the normal course of the profession or business. The fact that the principal owners or stockholders give personal attention or render valuable services to the corporation as a result of which its earnings are greater than those of a corporation engaged in a like or similar business, the principal owners or stockholders of which do not devote personal attention to the management or supervision of its affairs, does not of itself constitute the corporation a personal service corporation.

ART. 1529. **Activities of stockholders of personal service corporation: stock interest required.**—No definite percentage of stock or interest in the corporation which must be held by those engaged in the active conduct of its affairs in order that they may be deemed to be the principal owners or stockholders can be prescribed as a conclusive test, as other facts may affect any presumption so established. No corporation or its owners or stockholders shall, however, make a return in the first instance on the basis of its being a personal service corporation unless at least 80 per cent of its stock is held by those regularly engaged in the active conduct of its affairs.

ART. 1530. **Activities of stockholders of personal service corporation: change in ownership.**—The fact that the owners or stockholders of the corporation may change during the course of the taxable year does not take a corporation which is normally in the personal service class out of that class. Frequent changes in the ownership of any substantial interest or number of shares are, however, evidence bearing on the question as to whether the principal owners or stockholders are actively engaged in the conduct of the affairs of the corporation. The incapacity, retirement or death of a principal owner or stockholder who has been actively engaged in the conduct of its affairs will not be deemed to make any change in the status of the corporation during a reasonable time thereafter.

ART. 1531. **Capital of personal service corporation.**—In determining whether a corporation is a personal service corporation, no weight can be given to the fact that the invested capital of the corporation for the purpose of the war profits and excess profits tax or the actual investment of the principal owners or stockholders is comparatively small. The test established by the statute with respect to capital is entirely different. That test is the nature of the profession or business as indicated (*a*) by the kind of services it renders and (*b*) the extent to which capital is required to carry on such profession or business. If the use of capital is necessary or more than incidental, capital is a material income-producing factor and the corporation is not a personal service corporation. No corporation is a personal service corporation if it carries on business of a kind which ordinarily requires the use of capital, irrespective of whether the owners or stockholders have actually invested a substantial amount of capital.

ART. 1532. **Capital of personal service corporation: inference from use.**—The term "capital" as used in section 200 of the statute and in articles 1523–1532 means not only capital actually invested by the owners or stockholders, but also capital secured in other ways. Thus if capital is borrowed either directly as shown by bonds, debentures, certificates of indebtedness, notes, bills payable or other paper, or indirectly as shown by accounts payable or other forms of credit, or if the business of the corporation is in any way financed by or through any of the owners or stockholders, these facts will be deemed evidence that the use of capital is necessary. If a substantial amount of capital is used to finance or carry the accounts of clients or customers, it will be inferred that because of competition or other reasons such practice is necessary in order to secure or hold business which otherwise would be lost, and that the corporation is not a personal service corporation. If a corporation engaged in an agency, brokerage or commision business regularly employs a substantial amount of capital to lend to principals, to buy and carry goods on its own account, or to buy and carry odd lots in order that it may render more satisfactory service to its principals or customers, it is not a personal service corporation. In general the larger the amount of the capital actually used the stronger is the evidence that capital is necessary and is a material income-producing factor and that the corporation is not a personal service corporation.

ART. 1533. **"Taxable year," "witholding agent" and "paid."**—The taxable year is the time unit for the purpose of the tax. See section 212 of the statute and article 22. A withholding agent may be a corporation with bonds outstanding, a trustee under a corporate mortgage, or any corporation, partnership or private individual. See section 221 and articles 361–376. "Paid" is to be construed in each instance in the light of the method used in computing net income, whether on an accrual or a receipt basis. See article 23.

DIVIDENDS.

SEC. 201. (a) That the term "dividend" when used in this title (except in paragraph (10) of subdivision (a) of section 234) means (1) any distribution made by a corporation, other than a personal service corporation, to its shareholders or members, whether in cash or in other property or in stock of the corporation,[1] out of its earnings or profits accumulated since February 28, 1913, or (2) any such distribution made by a personal service corporation out of its earnings or profits accumulated since February 28, 1913, and prior to January 1, 1918.

(b) Any distribution shall be deemed to have been made from earnings or profits unless all earnings and profits have first been distributed. Any distribution made in the year 1918 or any year thereafter shall be deemed to have been made from earnings or profits accumulated since February 28, 1913, or, in the case of a personal service corporation, from the most recently accumulated earnings or profits; but any earnings or profits accumulated prior to March 1, 1913, may be distributed in stock dividends or otherwise, exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed.

(c) A dividend paid in stock of the corporation shall be considered income to the amount of the earnings or profits distributed.[1] Amounts distributed in the liquidation of a corporation shall be treated as payments in exchange for stock or shares, and any gain or profit realized thereby shall be taxed to the distributee as other gains or profits.

(d) If any stock dividend (1) is received by a taxpayer between January 1 and November 1, 1918, both dates inclusive, or (2) is during such period bona fide authorized or declared, and entered on the books of the corporation, and is received by a taxpayer after November 1, 1918, and before the expiration of thirty days after passage of this Act, then such dividend shall, in the manner provided in section 206, be taxed to the recipient at the rates prescribed by law for the years in which the corporation accumulated the earnings or profits from which such dividend was paid, but the dividend shall be deemed to have been paid from the most recently accumulated earnings or profits.[1]

(e) Any distribution made during the first sixty days of any taxable year shall be deemed to have been made from earnings or profits accumulated during preceding taxable years; but any distribution made during the remainder of the taxable year shall be deemed to have been made from earnings or profits accumulated between the close of the preceding taxable year and the date of distribution, to the extent of such earnings or profits, and if the books of the corporation do not show the amount of such earnings or profits, the earnings or profits for the accounting period within which the distribution was made shall be deemed to have been accumulated ratably during such period.

ART. 1541. **Dividends.**—Dividends for the purpose of the statute comprise any distribution in the ordinary course of business, even though extraordinary in amount, made by a domestic or foreign corporation to its shareholders out of its earnings or profits accumulated since February 28, 1913, and in the case of a personal service corporation prior to January 1, 1918. The mere declaration of a dividend is not a distribution. Dividends are income and are taxed at the rates for the year in which paid, regardless of when the earnings or profits out of which they were paid were accumulated. Although interest on State bonds and certain other obligations is not taxable when received by a corporation, upon amalgamation with the other funds of the corporation such income loses its identity and when distributed to stockholders in dividends is taxable to the same extent as other dividends. See further articles 54 and 858.

ART. 1542. **Presumption as to source of distribution.**—In the case of a corporation other than a personal service corporation any distribution to stockholders is deemed to have made so far as possible (*a*) from earnings or profits; (*b*) during the year 1918 or thereafter from earnings or profits accumulated since February 28, 1913; (*c*) if during the first sixty days of a taxable year, from earnings or profits

[1] See *Eisner* v. *Macomber*, T. D. 3010.

accumulated during preceding taxable years; and (*d*), if during the remainder of a taxable year after the first sixty days, from earnings or profits accumulated during the taxable year up to the date of distribution. The presumption contained in clauses (*c*) and (*d*) affects the determination of invested capital for the purpose of the war profits and excess profits tax, but has no effect upon the rates at which dividends paid in 1918 and subsequent years are taxed. In ascertaining whether or not a distribution was made out of earnings or profits of the taxable year there should first be set aside a proper reserve for the payment of accrued income and war profits and excess profits taxes. See article 857. In the case of a personal service corporation any distribution is deemed to have been made so far as possible (*a*) from earnings or profits; (*b*) during the year 1918 or thereafter from earnings or profits accumulated since February 28, 1913; (*c*) if during the first sixty days of a taxable year, from the most recently accumulated earnings or profits of preceding taxable years; and (*d*) if during the remainder of the taxable year after the first sixty days, from earnings or profits accumulated during the taxable year up to the date of distribution.

ART. 1543. **Distributions which are not dividends.**—A distribution by a corporation out of earnings or profits accumulated prior to March 1, 1913, or out of any assets except earnings or profits accumulated since February 28, 1913, is not a dividend within the meaning of the statute. A distribution by a personal service corporation out of earnings or profits accumulated since December 31, 1917, is not a dividend. A distribution out of earnings or profits accumulated before March 1, 1913, is free from tax as a dividend; out of assets other than earnings or profits accumulated since February 28, 1913, may or may not be free from tax, according as each stockholder receives more or less than he paid for his stock or its fair market value as of March 1, 1913; and, in the case of a personal service corporation, out of earnings or profits accumulated since December 31, 1917, is taxed to the stockholders as though they were partners. See section 218 of the statute and articles 328–335. In determining whether a distribution is made out of earnings or profits accumulated after or before March 1, 1913, due consideration must be given to the facts and mere book entries increasing or decreasing the surplus will not be conclusive.

ART. 1544. **Dividends paid in property.**—Dividends paid in securities or other property (other than its own stock), in which the earnings of a corporation have been invested, are income to the recipients to the amount of the fair market value of such property when receivable by the stockholders. A dividend paid in stock of another corporation is not a stock dividend. Where a corporation declares a dividend payable in stock of another corporation, setting aside the stock to be so distributed and notifying the stockholders of its action, the income arising to the recipients of such stock is its fair market value at the time the dividend becomes payable. See article 53. Scrip dividends are subject to tax in the year in which the warrants are issued.

ART. 1547. **Sale of stock received as dividend.**—Stock in a corporation received as a dividend does not constitute taxable income to a stockholder in such corporation, but any profit derived by the stockholder from the sale of such stock is taxable income to him. For the purpose of ascertaining the gain or loss derived from the sale of such stock, or from the sale of the stock with respect to which it is issued, the cost (used to include also, where required, the fair market value as of March 1, 1913), of both the old and new shares is to be determined in accordance with the following rules:

(1) Where the stock issued as a dividend is all of substantially the same character or preference as the stock upon which the stock dividend is paid, the cost of each share of both the old and new stock will be the quotient of the cost, or fair market value as of March 1, 1913, if acquired prior to that date, of the old shares of stock divided by the total number of the old and new shares.

(2) Where the stock issued as a dividend is in whole or in part of a character or preference materially different from the stock upon which the stock dividend is paid, the cost, or fair market value as of March 1, 1913, if acquired prior to that date, of the old shares of stock shall be divided between such old stock and the new stock, or classes of new stock, in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are issued, and the cost of each share of stock will be the quotient of the cost of the class to which such share belongs divided by the number of shares in that class.

(3) Where the stock with respect to which a stock dividend is issued was purchased at different times and at different prices and the identity of the lots can not be determined, any sale of the original stock will be charged to the earliest purchases of such stock (see article 39), and any sale of dividend stock issued with respect to such stock will be presumed to have been made from the stock issued with respect to the earliest purchased stock, to the amount of the dividend chargeable to such stock.

ART. 1548. **Distribution in liquidation.**—So-called liquidation or dissolution dividends are not dividends within the meaning of the statute, and amounts so distributed, whether or not including any surplus earned since February 28, 1913, are to be regarded as payments for the stock of the dissolved corporation. Any excess so received over the cost of his stock to the stockholder, or over its fair market value as of March 1, 1913, if acquired prior thereto, is a taxable profit. A distribution in liquidation of the assets and business of a corporation, which is a return to the stockholder of the value of his stock upon a surrender of his interest in the corporation, is distinguishable from a dividend paid by a going corporation out of current earnings or accumulated surplus when declared by the directors in their discretion, which is in the nature of a recurrent return upon the stock.

ART. 1549. **Distribution from depletion or depreciation reserve.**—A reserve set up out of gross income by a corporation and maintained for the purpose of making good any loss of capital assets on account of depletion or depreciation is not a part of its surplus out of which ordinary dividends may be paid. A distribution made from such a reserve will be considered a liquidating dividend and will constitute taxable income to a stockholder only to the extent that the amount so received is in excess of the cost or fair market value as of March 1, 1913, of his shares of stock. No distribution, however, will be deemed to have been made from such a reserve except to the extent that the amount paid exceeds the surplus and undivided profits of the corporation. In general, any distribution made by a corporation other than out of earnings or profits accumulated since February 28, 1913, is to be regarded as a return to the stockholder of part of the capital represented by his shares of stock, and upon a subsequent sale of such stock his profit will be the excess of the selling price over the cost of the stock or its fair market value as of March 1, 1913, after applying on such cost or value the amount of any such capital distribution.

BASIS FOR DETERMINING GAIN OR LOSS.

SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203.

(b) When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; but when in connection with the reorganization, merger, or consolidation of a corporation a person receives in place of stock or securities owned by him new stock or securities of no greater aggregate par or face value, no gain or loss shall be deemed to occur from the exchange, and the new stock or securities received shall be treated as taking the place of the stock, securities, or property exchanged.

When in the case of any such reorganization, merger, or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock or securities exchanged, a like amount in par or face value of the new stock or securities received shall be treated as taking the place of the stock or securities exchanged, and the amount of the excess in par or face value shall be treated as a gain to the extent that the fair market value of the new stock or securities is greater than the cost (or if acquired prior to March 1, 1913, the fair market value as of that date) of the stock or securities exchanged.

ART. 1561. **Basis for determining gain or loss from sale.**—For the purpose of ascertaining the gain or loss from the sale or exchange of property the basis is (*a*) its fair market price or value as of March 1, 1913, if acquired prior thereto, or (*b*), if acquired on or after that date, its cost or its approved inventory value. In both cases proper adjustment must be made for any depreciation or depletion sustained. What the fair market price or value of property was on March 1, 1913, is a question of fact to be established by any evidence which will reasonably and adequately make it appear. As to inventories see section 203 of the statute and articles 1581–1588. The fair market value as of March 1, 1913, has no bearing on the determination of the invested capital of a corporation for the purpose of the war profits and excess profits tax. See section 326 and article 831.

ART. 1562. **Sale of property acquired by gift or bequest.**—In the case of property acquired by gift, bequest, devise, or descent the basis for computing gain or loss on a sale is the fair market price or value of the property at the date of acquisition or as of March 1, 1913, if acquired prior thereto. For the purpose of determining the profit or loss from the sale of property acquired by bequest, devise, or descent since February 28, 1913, its value as appraised for the purpose of the federal estate tax, or in the case of estates not subject to that tax its value as appraised in the State court for the purpose of State inheritance taxes, should be deemed to be its fair market value when acquired. See section 213 (b) (3) of the statute and article 73.

ART. 1563. **Exchange of property.**—Gain or loss arising from the acquisition and subsequent disposition of property is realized when as the result of a transaction between the owner and another person the property is converted into cash or into property (*a*) that is essentially different from the property disposed of, and (*b*) that has a market value. In other words, both (*a*) a change in substance and not merely in form, and (*b*) a change into the equivalent of cash, are required to complete or close a transaction from which income may be realized. By way of illustration, if a man owning ten shares of listed stock exchanges his stock certificate for a voting trust certificate, no income is realized, because the conversion is merely in form; or if he exchanges his stock for stock in a small, closely held corporation, no income is realized if the new stock has no market value, although the conversion is more than formal; but if he exchanges his stock for a Liberty bond, income may be realized, because the conversion is into independent property having a market value. "Market value" is the price at which a seller willing to sell at a fair price and a buyer willing to buy at a fair price, both having reasonable knowledge of the facts, will trade. Property received in exchange for other property has no "fair market value" for the purpose of determining gain or loss resulting from such exchange when, owing to the condition of the market, there can be no reasonable expectation that the owner of the property, though wishing to sell and any person wishing to buy will agree upon a price at which to trade unless one or the other is under some peculiar compulsion. It does not follow that property has no "fair market value" merely because there is no price therefor established by public sales or sales in the way of ordinary business. The property received in exchange may be real estate, personal property, or a chose in action. Where the owner of a bond exercises the right, provided for in the bond, of converting the bond into stock in the obligor corporation, such transaction does not result in a realization of profit or loss, the transaction not being closed for purposes of income taxation until such stock is sold.

ART. 1564. **Determination of gain or loss from exchange of property.**—(*a*) The amount of income derived in the case of an exchange of property, as of stock for a bond, is the excess of the fair market value at the time of exchange of the bond received in exchange over the original cost of the stock exchanged for it, or over the fair market price or value of such stock as of March 1, 1913, if acquired before that date. The amount of income derived from a subsequent sale of the bond for cash is the excess of the amount so received over the fair market value of such bond when acquired in exchange for the stock. (*b*) On the other hand, if the property received in exchange is substantially the same property or has no market value, then no gain or loss is realized, but the new property is to be regarded as substituted for the old and upon a sale of the new property the amount of income derived is the excess of the amount so received over the cost or fair market value as of March 1, 1913, of the old.

ART. 1565. **Exchange for different kinds of property.**—(*a*) If property is exchanged for two different kinds of property, such as bonds and stock, the bonds having a market value and the stock none, the value of the bonds is to be compared with the cost or fair market value as of March 1, 1913, of the original property, as the case may be. If the market value of the bonds is less than such cost or value, the difference represents the cost of the stock. If the market value of the bonds is greater than such cost or value, the difference is taxable income at the time of the exchange and whenever sold the entire proceeds of the stock will be taxable. (*b*) If property is exchanged for two different kinds of property, such as bonds and stock, neither having a market value, the cost or fair market value as of March 1, 1913, of the original property should be apportioned, if possible, between the bonds and stock for the purpose of determining gain or loss on subsequent sales. If no fair apportionment is practicable, no profit on any subsequent sale of any part of the bonds or stock is realized until out of the proceeds of sales shall have been recovered the entire cost or fair market value as of March 1, 1913, of the original property.

Art. 1566. **Exchange of property and stock.**—Where property is transferred to a corporation in exchange for its stock, the exchange constitutes a closed transaction and the former owner of the property realizes a gain or loss if the stock has a market value, and such market value is greater or less than the cost or the fair market value as of March 1, 1913 (if acquired prior thereto), of the property given in exchange. For the rule applicable where a corporation, in connection with a reorganization, merger, or consolidation, exchanges property for stock, see article 1567.

Art. 1567. **Exchange of stock for other stock of no greater par value.**—In general, where two (or more) corporations unite their properties, by either (*a*) the dissolution of corporation B and the sale of its assets to corporation A, or (*b*) the sale of its property by B to A and the dissolution of B, or (*c*) the sale of the stock of B to A and the dissolution of B, or (*d*) the merger of B into A, or (*e*) the consolidation of the corporations, no taxable income is received from the transaction by A or B or the stockholders of either, provided the sole consideration received by B and its stockholders in (*a*), (*b*), (*c*), and (*d*) is stock or securities of A, and by A and B and their stockholders in (*e*) is stock or securities of the consolidated corporation, in any case of no greater aggregate par or face value than the old stock and securities surrendered. The term "reorganization," as used in section 202 of the statute, includes cases of corporate readjustment where stockholders exchange their stock for the stock of a holding corporation, provided the holding corporation and the original corporation, in which it holds stock, are so closely related that the two corporations are affiliated as defined in section 240(b) of the statute and article 633, and are thus required to file consolidated returns. So-called "no-par-value stock" issued under a statute or statutes which require the corporation to fix in a certificate or on its books of account or otherwise an amount of capital or an amount of stock issued which may not be impaired by the distribution of dividends, will for the purpose of this section be deemed to have a par value representing an aliquot part of such amount, proper account being taken of any preferred stock issued with a preference as to principal. In the case (if any) in which no such amount of capital or issued stock is so required, "no-par-value stock" received in exchange will be regarded for purposes of this section as having in fact no par or face value, and consequently as having "no greater aggregate par or face value" than the stock or securities exchanged therefor.

Art. 1568. **Determination of gain or loss from subsequent sale.**—The new stock and securities received as described in the preceding article take the place of the old stock and securities. For the purpose, therefore, of ascertaining the gain derived or loss sustained from the subsequent sale of any stock of A or of the consolidated corporation, so received, the original cost to the taxpayer or the fair market value as of March 1, 1913, of the stock of B or A in respect of which the new stock was issued, less any untaxed distribution made to the taxpayer by A out of the former capital or surplus of B, or by the consolidated corporation out of the former capital or surplus of A or B, is the basis for determining the amount of such gain or loss. When securities of a single class are exchanged for new securities of the same total par value but of different classes for purposes of determining profit or loss on subsequent sale of any of the new securities, the proportion of original cost (or value as of Mar. 1, 1913) to be allocated to each class of new securities is that proportion which the market value of the particular class bears to the market value of all securities received on the date of the exchange. For example, if 100 shares of common stock, par value $100, are exchanged for 50 shares of preferred and 50 shares of common each of $100 par value, and the cost of the old stock was $250 per share, or $25,000, but the market value of the preferred on the date of exchange was $110 per share, or $5,500 for the 50 shares, and the market value of the common was $440 per share, or $22,000 for the 50 shares of common, one-fifth of the original cost, or $5,000, would be regarded as the cost of the preferred and four-fifths, or $20,000, as the cost of the common. Similarly, the cost after reorganization, merger, or consolidation of the assets of A or of the consolidated corporation is the sum of the cost (or the fair market value as of Mar. 1, 1913) of the assets of A and of B for the purpose of ascertaining the gain or loss upon a subsequent sale. The new invested capital of A or of the consolidated corporation is to be determined as if A and B were rendering a consolidated return as affiliated corporations. See sections 240 and 326 of the statute and articles 631–638 and 864–869.

Art. 1569. **Exchange of stock for other stock of greater par value.**—If in the case of any reorganization, merger, or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock and securities exchanged, income will be realized from the transaction by the recipients of the new stock or securities to an amount limited by (*a*) the excess of the par or face value of the new stock or securities over the par or face value of the old and (*b*) the excess of the fair market value of the new stock or securities over the cost or fair market value as of March 1, 1913, of the old. In other words, the taxable profit will be (*a*) or (*b*), whichever is less. Upon a subsequent sale of the new stock or securities their cost to the taxpayer will be the cost or fair market value as of March 1, 1913, of the old stock and securities, plus the profit taxed on the exchange.

ART. 1570. **Readjustment of partnership interests.**—When a partner retires from a partnership, or it is dissolved, he realizes a gain or loss measured by the difference between the price received for his interest and the cost to him or (if acquired prior thereto) the fair market value as of March 1, 1913, of his interest in the partnership, including in such cost or value the amount of his share in any undistributed partnership net income earned since February 28, 1913, on which the income tax has been paid. If, however, the partnership distributes its assets in kind and not in cash, the partner realizes no gain or loss until he disposes of the property received on distribution. See article 1566. Whenever a new partner is admitted to a partnership, or any existing partnership is reorganized, the facts as to such change or reorganization should be fully set forth in the next return of income, in order that the Commissioner may determine whether any gain or loss has been realized by any partner. See also article 1563.

INVENTORIES.

SEC. 203. That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

ART. 1581. **Need of inventories.**—In order to reflect the net income correctly, inventories at the beginning and ending of each year are necessary in every case in which the production, purchase or sale of merchandise is an income-producing factor. The inventory should include raw materials and supplies on hand that have been acquired for sale, consumption or use in productive processes, together with all finished or partly finished goods. Title to the merchandise included in the inventory should be vested in the taxpayer and goods merely ordered for future delivery and for which no transfer of title has been effected should be excluded. The inventory should include mechandise sold but not shipped to the customer at the date of the inventory, together with any merchandise out upon consignment, but if such goods have been included in the sales of the taxable year they should not be taken in the inventory. It should also include merchandise purchased, although not actually received, to which title has passed to the purchaser. In this regard care should be exercised to take into the accounts all invoices or other charges in respect of merchandise properly included in the inventory, but which is in transit or for other reasons has not been reduced to physical possession.

ART. 1582. **Valuation of inventories.**—Inventories must be valued at (*a*) cost or (*b*) cost or market, as defined in article 1584 as amended, whichever is lower. (See article 1585 for inventories by dealers in securities.) Whichever basis is adopted must be applied consistently to the entire inventory. A taxpayer may, regardless of his past practice, adopt the basis of "cost or market whichever is lower", for his 1920 inventory, provided a disclosure of the fact and that it represents a change is made in the return. Thereafter changes can be made only after permission is secured from the Commissioner. Inventories should be recorded in a legible manner, properly computed and summarized, and should be preserved as a part of the accounting records of the taxpayer. Goods taken in the inventory which have been so intermingled that they can not be identified with specific invoices will be deemed to be the goods most recently purchased.

ART. 1583. **Inventories at cost.**—Cost means:

(1) In the case of merchandise purchased, the invoice price less trade or other discounts, except strictly cash discounts, approximating a fair interest rate, which may be deducted or not at the option of the taxpayer, provided a consistent course is followed. To this net invoice price should be added transportation or other necessary charges incurred in acquiring possession of the goods.

(2) In the case of merchandise produced by the taxpayer, (*a*) the cost of raw materials and supplies entering into or consumed in connection with the product, (*b*) expenditures for direct labor, (*c*) indirect expenses incident to and necessary for the production of the particular article, including in such indirect expenses a reasonable proportion of management expenses, but not including any cost of selling or return on capital whether by way of interest or profit. In any industry in which the usual rules for computation of cost of production are inapplicable, costs may be approximated upon such basis as may be reasonable and in conformity with established trade practice in the particular industry.

ART. 1584. **Inventories at market.**—Under ordinary circumstances, "market" means the current bid price prevailing at the date of the inventory for the particular merchandise in the volume in which ordinarily purchased by the taxpayer, and is applicable in the cases (*a*) of goods purchased and on hand, and (*b*) of basic elements of cost (materials, labor and burden) in goods in proces of manufacture and in finished goods on hand; exclusive, how ever, of goods on hand or in process of manufacture for deliver upon firm sales contracts at fixed prices entered into before the dat of the inventory, which goods must be inventoried at cost. Wher no open market quotations are available, the taxpayer must use sucl evidence of a fair market price at the date or dates nearest the in ventory as may be available, such as specific transactions in reason able volume entered into in good faith, or compensation paid fo cancellation of contracts for purchase commitments. Where, owin to abnormal conditions, the taxpayer has regularly sold such mer chandise at prices lower than the current bid price as above defined the inventory may be valued at such prices, and the correctness o such prices will be determined by reference to the actual sales of th taxpayer for a reasonable period before and after the date of th inventory. Prices which vary materially from the actual prices so ascertained will not be accepted as reflecting the market and the penalties prescribed for filing false and fraudulent returns may be asserted. Goods in process of manufacture may be valued for purposes of the inventory on the lowest of the following bases: (1) the replacement or reproduction cost prevailing at the date of the inventory; or (2) the proper proportionate part of the actual finished cost; or, under abnormal conditions, (3) the proper proportionate part of the sales price of the finished product, account being taken in all cases of the proportionate part of the total cost of basic elements (materials, labor and burden) represented in such goods in process of manufacture at the stages at which they are found on the date of the inventory. The inventories of taxpayers on whatever basis taken will be subject to investigation by the Commissioner, and the taxpayer must satisfy the Commissioner of the correctness of the prices adopted. He must be prepared to show both the cost and the market price of each article included in the inventory. It is recognized that in the latter part of 1918, by reason among other things of governmental control not having been relinquished, conditions were abnormal and in many commodities there was no such scale of trading as to establish a free market. In such a case, when a market was established during the succeeding year, a claim may be filed for any loss sustained in accordance with the provisions of section 214 (a) (12) or section 234 (a) (14) of the statute. See articles 261–268.

ART. 1585. **Inventories by dealers in securities.**—A dealer in securities, who in his books of account regularly inventories unsold securities on hand either (*a*) at cost or (*b*) at cost or market value, whichever is lower, may make his return upon the basis upon which his accounts are kept; provided that a description of the method employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years, unless another be authorized by the Commissioner. For the purpose of this rule a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers, that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation, and not in the course of an established business, and officers of corporations and members of partnerships, who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule.

Art. 1586. **Inventories of live-stock raisers and other farmers.**—(1) Farmers may change the basis of their returns from that of receipts and disbursements to that of an inventory basis, which necessitates the use of opening and closing inventories for the year in which the change is made. There should be included in the opening inventory all farm products (including live stock) purchased or raised which were on hand at the date of the inventory, and there must be submitted with the return for the current taxable year an adjustment sheet for 1917 and each year thereafter (prior to the year in which the change is made) based on the inventory method; upon the amount of which adjustments the tax shall be assessed and paid (if any be due) at the rate of tax in effect for each respective year. Where it is impossible to render complete inventories from the beginning of the taxable year, 1917, the department will accept estimates which, in its opinion, substantially reflect the income on the inventory basis, for the year 1917 and thereafter; but inventories must not include real estate, buildings, permanent improvements or any other assets subject to depreciation.

(2) Because of the difficulty of ascertaining actual cost of live stock and other farm products, farmers who render their returns upon an inventory basis may at their option value their inventories for the current taxable year according to the "farm-price method" of determining costs, which provides for a valuation of inventories *at market price less cost of marketing.* If the use of the "farm-price method" of valuing inventories for any taxable year involves a change in method of pricing inventories from that employed in prior years, the opening inventory for the taxable year in which the change is made should be brought in at the same value as the closing inventory for the preceding taxable year (this being the same in

effect as valuing the opening inventory on the new basis and crediting income with the excess valuation brought in). If such valuation of the opening inventory for the taxable year in which the change is made results in an abnormally large income for that year, there may be submitted with the return for such taxable year an adjustment sheet for 1917 and each year thereafter (prior to the year in which the change is made), based on the "farm-price method" of valuing inventories; upon the amount of which adjustments the tax shall be assessed and paid as provided in paragraph (1) hereof.

(3) Where returns have been made in which the taxable net income has been computed upon *incomplete* inventories, the abnormality must be corrected by submitting with the return for the current taxable year an adjustment sheet for 1917 and each year thereafter (prior to the year in which the change is made), upon which such adjustments shall be made as are necessary to bring the closing inventory for the preceding year into agreement with the opening *complete* inventory for the current taxable year; upon the amount of which adjustments the tax shall be assessed and paid as provided in paragraph (1) hereof.

ART. 1587. **Inventories of lumber manufacturers.**—1. Because of the impracticability of determining accurately the costs properly assignable to each species, grade, and dimension of lumber making up the product of the mill, lumber manufacturers may use as a basis for pricing inventories the average cost to the manufacturer of producing the inventoried products during the taxable year for which the return of net income is made.

2. If the quantity of lumber on hand at the time of inventory is greater than the total quantity of lumber produced during the current taxable year, it is evident that the excess stock has been carried over from the previous year's production, and such excess shall be valued at the average cost of production for the preceding taxable year.

3. A taxpayer who regularly allocates in his books of account such average cost to the different kinds and grades of lumber in proportion to the selling value of such kinds and grades may, subject in each case to the approval of the Commissioner upon audit of the return, make his returns of net income on that basis.

4. The term lumber manufacturer as used in this article means a person who manufactures lumber from logs, as distinguished from a remanufacturer of lumber.

ART. 1588. **Inventories of retail dry goods dealers.**—(1) Retail dry goods dealers who employ the "retail method," which is essentially a "cost" method of valuing inventories, will be permitted to make their returns upon that basis, provided (*a*) that the use of such method is designated upon the return, (*b*) that accurate accounts are kept, and (*c*) that such method be adhered to in subsequent years, unless a change is authorized by the Commissioner. The "retail method" consists in computing the "cost" of goods on hand from the "percentage of purchase mark-up" and the "retail value" of goods on hand.

(2) A taxpayer employing the "retail method" of valuing inventories shall maintain and preserve in permanent form, for the inspection of internal revenue officers, the accounts and records of each year, together with a schedule of all mark-downs in each department, and such mark-downs shall not be included in the computation of the retail value of goods on hand unless the goods so marked down have been actually sold.

(3) The following general plan of taking an inventory by the "retail method" will, it is believed, be found readily adaptable to the requirements of most retail dry goods dealers:

(A) The *percentage of purchase mark-up* is computed as follows: The value of all merchandise, as received, is recorded by departments at two prices, (*a*) invoice cost plus transportation and (*b*) original retail sale price. These cost and retail values are accumulated as recorded during the year. The total retail value minus the total cost value equals the total purchase mark-up, which divided by the total retail value gives the percentage of purchase mark-up.

(B) The *retail value of goods on hand* is computed as follows: A record is kept of (*a*) the amounts of all sales at retail, (*b*) any variations from the inventory prices of the preceding year of goods carried over from that year, and (*c*) any variations from the original sale prices, such as subsequent mark-ups or mark-downs (note par. 2). The retail value of the opening inventories plus the retail value of the purchases (plus or minus the algebraic sum of all subsequent mark-ups and mark-downs in the case of goods actually sold) minus the retail value of the sales equals the retail value of the book inventory of goods on hand. Physical inventories by departments are taken of goods on hand at retail at the close of the taxable year, and the retail value of the book inventory of goods on hand is adjusted accordingly.

(C) The *cost of goods on hand* is computed by subtracting from 100 per cent the percentage of purchase mark-up, which gives the percentage of cost, and multiplying the retail value of goods on hand by such percentage of cost.

NET LOSSES.

SEC. 204. (a) That as used in this section the term "net loss" refers only to net losses resulting from either (1) the operation of any business regularly carried on by the taxpayer, or (2) the bona fide sale by the taxpayer of plant, building, machinery, equipment or other facilities, constructed, installed or acquired by the taxpayer on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war; and when so resulting means the excess of the deductions allowed by law (excluding in the case of corporations amounts allowed as a deduction under paragraph (6) of subdivision (a) of section 234) over the sum of the gross income plus any interest received free from taxation both under this title and under Title III.

(b) If for any taxable year beginning after October 31, 1918, and ending prior to January 1, 1920, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount of such net loss shall under regulations prescribed by the Commissioner with the approval of the Secretary be deducted from the net income of the taxpayer for the preceding taxable year; and the taxes imposed by this title and by Title III for such preceding taxable year shall be redetermined accordingly. Any amount found to be due to the taxpayer upon the basis of such redetermination shall be credited or refunded to the taxpayer in accordance with the provisions of section 252. If such net loss is in excess of the net income for such preceding taxable year, the amount of such excess shall under regulations prescribed by the Commissioner with the approval of the Secretary be allowed as a deduction in computing the net income for the succeeding taxable year.

(c) The benefit of this section shall be allowed to the members of a partnership and the beneficiaries of an estate or trust under regulations prescribed by the Commissioner with the approval of the Secretary.

ART. 1601. **Scope of net losses.**—As used in the statute the term "net loss" means either a business operating loss or a loss realized by a bona fide sale of property constructed, installed or acquired on or after April 6, 1917, for the production of articles contributing to the prosecution of the war. The amount of net loss claimed must represent an actual net loss over and above all income, including tax-free income. Such losses will be allowable only in respect of a taxpayer having a taxable year beginning after October 31, 1918, and ending prior to January 1, 1920, and after one claim has been allowed no further claim can be considered.

ART. 1602. **Claim for allowance of net loss.**—A taxpayer having such a net loss may file a claim on form 46 (revised) with his return of income for the taxable year 1919. Such claim should contain a concise statement setting forth the amount of the loss sustained, in accordance with the accompanying return, the nature of the loss, the amount of the taxpayer's net income for the taxable year 1918, the taxes paid by him with respect thereto, and all pertinent facts necessary to enable the Commissioner to determine the allowability of the claim.

ART. 1603. **Allowance of net loss.**—The amount allowed by the Commissioner in respect of any such claim shall be deducted from the net income for the taxable year 1918 and the income and the war profits and excess profits tax, if any, for such year shall be recomputed accordingly. Any amount found to be due him shall be credited or refunded to the taxpayer. See section 252 of the statute and articles 1034–1036. In any case in which it is found by the Commissioner that such net loss is in excess of the net income of such preceding taxable year, the taxpayer may carry forward the amount of such excess and claim it as a deduction in computing net income for the succeeding taxable year.

FISCAL YEAR WITH DIFFERENT RATES.

SEC. 205. (a) That if a taxpayer makes return for a fiscal year beginning in 1917 and ending in 1918, his tax under this title for the first taxable year shall be the sum of: (1) the same proportion of a tax for the entire period computed under Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917 and under Title I of the Revenue Act of 1917, which the portion of such period falling within the calendar year 1917 is of the entire period, and (2) the same proportion of a tax for the entire period computed under this title at the rates for the calendar year 1918 which the portion of such period falling within the calendar year 1918 is of the entire period: *Provided,* That in the case of a personal service corporation the amount to be paid shall be only that specified in clause (1).

Any amount heretofore or hereafter paid on account of the tax imposed for such fiscal year by Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917, and by Title I of the Revenue Act of 1917, shall be credited towards the payment of the tax imposed for such fiscal year by this Act, and if the amount so paid exceeds the amount of such tax imposed by this Act, or, in the case of a personal service corporation, the amount specified in clause (1), the excess shall be credited or refunded in accordance with the provisions of section 252.

(b) If a taxpayer makes a return for a fiscal year beginning in 1918 and ending in 1919, the tax under this title for such fiscal year shall be the sum of: (1) the same proportion of a tax for the entire period computed under this title at the rates specified for the calendar year 1918 which the portion of such period falling within the calendar year 1918 is of the entire period, and (2) the same proportion of a tax for the entire period computed under this title at the rates specified for the calendar year 1919 which the portion of such period falling within the calendar year 1919 is of the entire period.

(c) If a fiscal year of a partnership begins in 1917 and ends in 1918 or begins in 1918 and ends in 1919, then notwithstanding the provisions of subdivision (b) of section 218, (1) the rates for the calendar year during which such fiscal year begins shall apply to an amount of each partner's share of such partnership net income (determined under the law applicable to such year) equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year and (2) the rates for the calendar year during which such fiscal year ends shall apply to an amount of each partner's share of such partnership net income (determined under the law applicable to such calendar year) equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year: *Provided,* That in the case of a personal service corporation with respect to a fiscal year beginning in 1917 and ending in 1918, the amount specified in clause (1) shall not be subject to normal tax.

ART. 1621. **Fiscal year with different rates.**—Section 205 of the statute applies to income taxes. For the provisions with respect to war profits and excess profits taxes see section 335 and articles 951–955. Subdivision (a), which deals with fiscal years beginning in 1917 and ending in 1918, applies to corporations, including personal service corporations, and to individuals. Subdivision (b), which deals with fiscal years beginning in 1918 and ending in 1919, applies to corporations other than personal service corporations and to individuals. Subdivision (c), which deals with fiscal years beginning in 1917 or 1918 and ending in 1918 or 1919, applies to partnerships and to personal service corporations. See as to partnerships articles 321–327, and as to personal service corporations articles 328–335.

ART. 1622. **Fiscal year of corporation ending in 1918.**—The method provided for computing the tax for a fiscal year beginning in 1917 and ending in 1918 is as follows: (*a*) The tax attributable to the calendar year 1917 is found by computing the income of the taxpayer and the tax thereon in accordance with Title I of the Revenue Act of 1916 as amended and Title I of the Revenue Act of 1917 as if the fiscal year was the calendar year 1917, and determining the proportion of such tax which the proportion of the fiscal year falling within the calendar year 1917 is of the full fiscal year; (*b*) the tax attributable to the calendar year 1918 is found by computing the income of the taxpayer and the tax thereon in accordance with the present statute as if the fiscal year was the calendar year 1918, and determining the proportion of such tax which the portion of such fiscal year falling within the calendar year is of the full fiscal year; and (*c*) the tax for the fiscal year is found by adding the tax attributable to the calendar year 1917 and the tax attributable to the calendar year 1918. If a corporation made its return for the taxable year 1917 on the calendar year basis and for the taxable year 1918 on a fiscal year basis, the tax attributable to the calendar year 1917 need not again be computed and the tax attributable to the calendar year 1918 computed as herein provided shall be the tax of the corporation for the portion of such fiscal year falling within the calendar year 1918. A personal service corporation is not required to pay the tax attributable to the calendar year 1918, since for that year it is treated substantially like a partnership for the purposes of taxation. See section 218 of the statute and articles 328–335.

ART. 1623. **Deductions and credits in the case of corporation fiscal year ending in 1918.**—Net losses deductible from net income of the fiscal year under the provisions of section 204 of the statute shall be deducted in computing the tax attributable to the calendar year 1917, as well as in computing the tax attributable to the calendar year 1918. In computing the tax attributable to the calendar year 1917 the net income computed for the entire period under Title I of the Revenue Act of 1916 as amended and Title I of the Revenue Act of 1917 shall be credited with the excess profits tax computed for the entire period under Title II of the Revenue Act of 1917. In computing the tax attributable to the calendar year 1918 the net income computed for the entire period under the present statute shall be credited with the war profits and excess profits tax computed for the entire period under Title III of the statute at the rates prescribed for 1918. See section 236 of the statute and article 591. Amounts previously paid by the taxpayer on account of the income tax for such fiscal year shall be credited towards the payment of the income tax imposed for such fiscal year by the present statute. Any excess shall be credited or refunded in accordance with the provisions of section 252. See articles 1031 and 1034–1036.

ART. 1624. **Fiscal year of individual ending in 1918.**—Since under the law applicable to the calendar year 1917 individuals were not permitted to make returns on the fiscal year basis (see Title I of the Revenue Act of 1916 as amended), the tax of an individual for that part of a fiscal year ending in 1918 attributable to the calendar year 1917 has already been included in the tax for such calendar year and need not ordinarily again be computed. The tax for that part of the year attributable to the calendar year 1918 is found by computing the income of the taxpayer for the taxable year and the tax thereon in accordance with the present statute as if the taxable year was the calendar year 1918, and determining the proportion of such tax which the portion of such fiscal year falling within the calendar year is of the full fiscal year.

ART. 1625. **Fiscal year of corporation or individual ending in 1919.**—The method provided for computing the tax for a fiscal year beginning in 1918 and ending in 1919 is as follows: (*a*) the tax attributable to the calendar year 1918 is found by computing the income of the taxpayer and the tax thereon in accordance with the statute as if the fiscal year was the calendar year 1918. and determining the proportion of such tax which the portion of such fiscal year falling within the calendar year is of the full fiscal year; (*b*) the tax attributable to the calendar year 1919 is found by computing the income of the taxpayer and the tax thereon in accordance with the statute as if the fiscal year was the calendar year 1919. and determining the proportion of such tax which the portion of such fiscal year falling within the calendar year is of the full fiscal year: and (*c*) the tax for the fiscal year is found by adding the tax attributable to the calendar year 1918 and the tax attributable to the calendar year 1919.

PARTS OF INCOME SUBJECT TO RATES FOR DIFFERENT YEARS.

SEC. 206. That whenever parts of a taxpayer's income are subject to rates for different calendar years, the part subject to the rates for the most recent calendar year shall be placed in the lower brackets of the rate schedule provided in this title, the part subject to the rates for the next preceding calendar year shall be placed in the next higher brackets of the rate schedule applicable to that year, and so on until the entire net income has been accounted for. In determining the income, any deductions, exemptions or credits of a kind not plainly and properly chargeable against the income taxable at rates for a preceding year shall first be applied against the income suoject to rates for the most recent calendar year; but any balance thereof shall be applied against the income subject to the rates of the next preceding year or years until fully allowed.

ART. 1641. **Parts of income subject to rates for different years.**—Section 206 of the statute applies to a partner's share of partnership net income, to a stockholder's share of the net income of a personal service corporation, and to a beneficiary's distributive share of income from an estate or trust. For the treatment of income of a partner or of a stockholder in a personal service corporation see sections 218 and 205 of the statutes and articles 321–335, 1621, and 1624.

ADVISORY TAX BOARD.

SEC. 1301. (d) (1) There is hereby created a Board to be known as the "Advisory Tax Board," hereinafter called the Board, and to be composed of not to exceed six members to be appointed by the Commissioner with the approval of the Secretary The Board shall cease to exist at the expiration of two years after the passage of this Act, or at such earlier time as the Commissioner with the approval of the Secretary may designate.

Vacancies in the membership of the Board shall be filled in the same manner as an original appointment. Any member shall be subject to removal by the Commissioner with the approval of the Secretary. The Commissioner with the approval of the Secretary shall designate the chairman of the Board. Each member shall receive an annual salary of $9,000, payable monthly, together with actual necessary expenses when absent from the District of Columbia on official business.

(2) The Commissioner may, and on the request of any taxpayer directly interested shall, submit to the Board any question relating to the interpretation or administration of the income, war-profits or excess-profits tax laws, and the Board shall report its findings and recommendations to the Commissioner.

(3) The Board shall have its office in the Bureau of Internal Revenue in the District of Columbia. The expenses and salaries of members of the Board shall be audited, allowed, and paid out of appropriations for collecting internal revenue, in the same manner as expenses and salaries of employees of the Bureau of Internal Revenue are audited, allowed, and paid.

(4) The Board shall have the power to summon witnesses, take testimony, administer oaths, and to require any person to produce books,

papers, documents, or other data relating to any matter under investigation by the Board. Any member of the Board may sign subpoenas and members and employees of the Bureau of Internal Revenue designated to assist the Board, when authorized by the Board, may administer oaths, examine witnesses, take testimony, and receive evidence.

EXTENSION OF EXISTING STATUTES.

SEC. 1305. That all administrative, special, or stamp provisions of law, including the law relating to the assessment of taxes, so far as applicable, are hereby extended to and made a part of this Act, and every person liable to any tax imposed by this Act, or for the collection thereof, shall keep such records and render, under oath, such statements and returns, and shall comply with such regulations as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

Whenever in the judgment of the Commissioner necessary he may require any person, by notice served upon him, to make a return or such statements as he deems sufficient to show whether or not such person is liable to tax.

The Commissioner, for the purpose of ascertaining the correctness of any return or for the purpose of making a return where none has been made, is hereby authorized, by any revenue agent or inspector designated by him for that purpose, to examine any books, papers, records or memoranda bearing upon the matters required to be included in the return, and may require the attendance of the person rendering the return or of any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take his testimony with reference to the matter required by law to be included in such return, with power to administer oaths to such person or persons.

ART. 1711. **Aids to collection of tax.**—In collecting the income and war profits and excess profits taxes the Commissioner has the benefit of all existing internal revenue laws. In aid of the enforcement of the statute the Commissioner may require any person to keep specified records, to render returns and statements as directed, to submit himself and his books to examination, and to comply with such regulations as may be prescribed. Section 3165 of the Revised Statutes, as amended by section 1317 of the Revenue Act of 1918, provides:

SEC. 3165. Every collector, deputy collector, internal-revenue agent, and internal-revenue officer assigned to duty under an internal-revenue agent, is authorized to administer oaths and to take evidence touching any part of the administration of the internal-revenue laws with which he is charged, or where such oaths and evidence are authorized by law or regulation authorized by law to be taken.

See also sections 228, 250, and 1318 of the statute and articles 451 and 1002.

FRACTIONAL PART OF CENT.

SEC. 1313. That in the payment of any tax under this Act not payable by stamp a fractional part of a cent shall be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to 1 cent.

ART. 1721. **When fractional part of cent may be disregarded.**—In the payment of income or war profits and excess profits taxes, and in each step or computation necessary in determining the amount of any such tax, a fractional part of a cent may be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to one cent.

MEDIUM OF PAYMENT OF TAX.

SEC. 1314. That collectors may receive, at par with an adjustment for accrued interest, certificates of indebtedness issued by the United States and uncertified checks in payment of income, war-profits and excess-profits taxes and any other taxes payable other than by stamp, during such time and under such regulations as the Commissioner, with the approval of the Secretary, shall prescribe; but if a check so received is not paid by the bank on which it is drawn the person by whom such check has been tendered shall remain liable for the payment of the tax and for all legal penalties and additions the same as if such check had not been tendered.

ART. 1731. **Payment of tax by certificates of indebtedness.**—Collectors of internal revenue are authorized and directed to receive at par United States Treasury certificates of indebtedness of Series T 8, dated July 15, 1919, Series T 9, dated September 15, 1919, Series T M 3–1920, dated December 1, 1919, and Series T M 4–1920, dated February 2, 1920, all maturing March 15, 1920, in payment of income and profits taxes payable on March 15, 1920. Collectors are authorized and directed to receive at par, Treasury certificates of indebtedness of Series T J–1920, dated December 15, 1919, maturing June 15, 1920, in payment of income and profits taxes payable on June 15, 1920; Treasury certificates of indebtedness of Series T 10 dated September 15, 1919, maturing September 15, 1920, in payment of income and profits taxes payable on September 15, 1920; and Treasury certificates of indebtedness of Series T D–1920, dated January 2, 1920, maturing December 15, 1920, in payment of income and profits taxes payable on December 15, 1920. Collectors are further authorized and directed to receive at par, in payment of income and profits taxes payable at the maturity of the certificates, respectively, Treasury certificates of indebtedness of any series maturing on March 15, June 15, September 15, or December 15, 1920, respectively, and expressed to be acceptable in payment of income and profits taxes. The terms of the acceptance of certificates of other issues will be prescribed from time to time.

ART. 1732. **Procedure with respect to certificates of indebtedness.**—Collectors are not authorized hereunder to receive in payment of income or profits taxes any Treasury certificates of indebtedness not expressed to be acceptable in payment of income and profits taxes, or maturing on a date other than the date on which the taxes are payable. Collectors are authorized to receive Treasury certificates of indebtedness which are acceptable as above provided in payment of income and profits taxes, in advance of the respective dates on which the certificates mature. Treasury certificates acceptable in payment of income and profits taxes have one or more interest coupons attached, including as to each series a coupon payable at the maturity of the certificates, but all interest coupons must in each case be detached by the taxpayer and collected in ordinary course when due. The amount, at par, of the Treasury certificates of indebtedness presented by any taxpayer in payment of income and profits taxes must not exceed the amount of the taxes to be paid by him, and collectors shall in no case pay interest on the certificates or accept them for an amount other or greater than their face value.

Deposits of Treasury certificates of indebtedness received in payment of income and profits taxes must be made by collectors, unless otherwise specifically instructed by the Secretary of the Treasury, with the Federal reserve bank of the district in which the collector's head office is located, or in case such head office is located in the same city with a branch Federal reserve bank, with such branch Federal reserve bank. Specific instructions may be given in certain instances for the deposit of the certificates with Federal reserve banks of other districts and branch Federal reserve banks. The term "Federal reserve bank," where it appears herein, unless otherwise indicated by the context, includes branch Federal reserve banks. Treasury certificates accepted by the collector prior to the dates when the certificates respectively mature should be forwarded by the collector to the Federal reserve bank to be held for account of the collector until the date of maturity and for deposit on such date.

Collectors of internal revenue are not authorized, unless otherwise notified by the Secretary of the Treasury, to receive in payment of income or profits taxes interim receipts issued by Federal reserve banks in lieu of definitive certificates of the series herein described.

Certificates of indebtedness should in all cases be stamped as follows by the collector, and when so stamped forwarded to the Federal reserve bank by registered mail uninsured:

---------------------------, 192--

This certificate has been accepted in payment of income and profits taxes and will not be redeemed by the United States except for credit of the undersigned.

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Collector of Internal Revenue.

For the -------- District of -------------------

Collectors should make in tabular form a schedule in duplicate of the certificates of indebtedness to be forwarded to the Federal reserve bank, showing the serial number of each certificate, the date of issue and maturity, and face value. Certificates of indebtedness accepted prior to the date of maturity must be scheduled separately. At the bottom of each schedule there should be written or stamped "Income and Profits Taxes $----------," which amount must agree with the total shown on the schedule. One copy of this schedule must accompany certificates sent to the Federal reserve bank and the other be retained by the collector. The income and profits tax deposits resulting from the deposits of such certificates must in all cases be shown on the face of the certificate of deposit (national bank form 15) separate and distinct from the item of miscellaneous internal revenue collections (formerly called ordinary), but it is not necessary to give the separation into corporation income, individual income, and profits taxes.

Until certificates of deposit are received from the Federal reserve banks, the amounts represented by the certificates of indebtedness forwarded must be carried by collectors as cash on hand, and not credited as collections, as the dates of certificates of deposit determine the dates of collections.

For the purpose of saving taxpayers the expense of transmitting such certificates as are held in Federal reserve cities or Federal reserve branch bank cities to the office of the collector in whose district the taxes are payable, taxpayers desiring to pay income and profits taxes by Treasury certificates of indebtedness acceptable in payment of such taxes should communicate with the collector of the district in which the taxes are payable and request from him authority to deposit such certificates with the Federal reserve bank or branch in the city in which the certificates are held. Collectors are authorized to permit deposits of Treasury certificates of indebtedness in any Federal reserve bank or branch with the distinct understanding that the Federal reserve bank or branch is to issue a certificate of deposit in the collector's name covering the amount of the certificates of indebtedness at par and to state on the face of the certificate of deposit that the amount represented thereby is in payment of income and profits taxes. The Federal reserve bank or branch should forward the original certificate of deposit to the Treasurer of the United States, with its daily transcript, and transmit to the collector the duplicate and triplicate, accompanied by a statement giving the name of the taxpayer for whom the payment is made, in order that the collector may make the necessary record and forward the duplicate to the office of the Commissioner of Internal Revenue.

ART. 1733. **Payment of tax by uncertified checks.**—Collectors may accept uncertified checks in payment of income and war profits and excess profits taxes, provided such checks are collectible at par, that is, for their full amount, without any deduction for exchange or other charges. The collector will stamp on the face of each check before deposit the words, "This check is in payment of an obligation to the United States and must be paid at par. No protest," with his name and title. The day on which the collector receives the check will be considered the date of payment so far as the taxpayer is concerned, unless the check is returned dishonored. If one check is remitted to cover two or more persons' taxes, the remittance must be accompanied by a letter of transmittal stating (*a*) the name of the drawer of the check; (*b*) the amount of the check; (*c*) the amount of any cash, money order or other instrument included in the same remittance; (*d*) the name of each person whose tax is to be paid by the remittance; (*e*) the amount of the payment on account of each person; and (*f*) the kind of tax paid.

ART. 1734. **Procedure with respect to dishonored checks.**—If the bank on which any such check is drawn should refuse to pay it at par, the check should be returned through the depositary bank and be treated in the same manner as a bad check. All expenses incident to the attempt to collect such a check and the return of it through the depositary bank must be paid by the drawer of the check to the bank on which it is drawn, since no deduction can be made from amounts received in payment of taxes. See section 3210 of the Revised Statutes. If any taxpayer whose check has been returned uncollected by the depositary bank should fail at once to make the check good, the collector should proceed to collect the tax as though no check had been given. A taxpayer who tenders a certified check in payment for taxes is also not released from his obligation until the check has been paid. See chapter 191 of the Act of March 2, 1911.

JURISDICTION OF DISTRICT COURTS.

SEC. 1318. That if any person is summoned under this Act to appear, to testify, or to produce books, papers or other data, the district court of the United States for the district in which such person resides shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, or other data.

The district courts of the United States at the instance of the United States are hereby invested with such jurisdiction to make and issue, both in actions at law and suits in equity, writs and orders of injunction, and of ne exeat republica, orders appointing receivers, and such other orders and process, and to render such judgments and decrees, granting in proper cases both legal and equitable relief together, as may be necessary or appropriate for the enforcement of the provisions of this Act. The remedies hereby provided are in addition to and not exclusive of any and all other remedies of the United States in such courts or otherwise to enforce such provisions.

DEPOSIT OF UNITED STATES BONDS AS SECURITY.

SEC. 1320. That wherever by the laws of the United States or regulations made pursuant thereto, any person is required to furnish any recognizance, stipulation, bond, guaranty, or undertaking, hereinafter called "penal bond," with surety or sureties, such person may, in lieu of such surety or sureties, deposit as security with the official having authority to approve such penal bond, United States Liberty bonds or other bonds of the United States in a sum equal at their par value to the amount of such penal bond required to be furnished, together with an agreement authorizing such official to collect or sell such bonds so deposited in case of any default in the performance of any of the conditions or stipulations of such penal bond. The acceptance of such United States bonds in lieu of surety or sureties required by law shall have the same force and effect as individual or corporate sureties, or certified checks, bank drafts, post-office money orders, or cash, for the penalty or amount of such penal bond. The bonds deposited hereunder, and such other United States bonds as may be substituted therefor from time to time as such security, may be deposited with the Treasurer, or an Assistant Treasurer of the United States, a Government depository, Federal Reserve bank, or member bank, which shall issue receipt therefor, describing such bonds so deposited. As soon as security for the performance of such penal bond is no longer necessary, such bonds so deposited, shall be returned to the depositor: *Provided*, That in case a person or persons supplying a contractor with labor or material as provided by the Act of Congress, approved February 24, 1905 (33 Stat., 811), entitled "An Act to amend an Act approved August thirteenth, eighteen hundred and ninety-four, entitled 'An Act for the protection of persons furnishing materials and labor for the construction of public works,'" shall file with the obligee, at any time after a default in the performance of any contract subject to said Acts, the application and affidavit therein provided, the obligee shall not deliver to the obligor the deposited bonds nor any surplus proceeds thereof until the expiration of the time limited by said Acts for the institution of suit by such person or persons, and, in case suit shall be instituted within such time, shall hold said bonds or proceeds subject to the order of the court having jurisdiction thereof: *Provided further*, That nothing herein contained shall affect or impair the priority of the claim of the United States against the bonds deposited or any right or remedy granted by said Acts or by this section to the United States for default upon any obligation of said penal bond: *Provided further*, That all laws inconsistent with this section are hereby so modified as to conform to the provisions hereof: *And provided further*, That nothing contained herein shall affect the authority of courts over the security, where such bonds are taken as security in judicial proceedings, or the authority of any administrative officer of the United States to receive United States bonds for security in cases authorized by existing laws. The Secretary may prescribe rules and regulations necessary and proper for carrying this section into effect.

REPEAL OF FORMER ACTS.

SEC. 1400. (a) That the following parts of Acts are hereby repealed, subject to the limitations provided in subdivision (b):

(1) The following titles of the Revenue Act of 1916:

Title I (called "Income Tax");

Title II (called "Estate Tax");
Title III (called "Munitions Manufacturers' Tax"), as amended;
Title IV (called "Miscellaneous Taxes").

(2) The following parts of the Act entitled "An Act to provide increased revenue to defray the expenses of the increased appropriations for the Army and Navy and the extensions of fortifications, and for other purposes," approved March 3, 1917:

Title III (called "Estate Tax");
Section 402 (called "Returns of Dividends").

(3) The following titles of the Revenue Act of 1917:

Title I (called "War Income Tax");
Title II (called "War Excess-Profits Tax");
Title III (called "War Tax on Beverages");
Title IV (called "War Tax on Cigars, Tobacco, and Manufactures Thereof");
Title V (called "War Tax on Facilities Furnished by Public Utilities, and Insurance");
Title VI (called "War Excise Taxes");
Title VII (called "War Tax on Admissions and Dues");
Title VIII (called "War-Stamp Taxes");
Title IX (called "War Estate Tax");
Title X (called "Administrative Provisions");
Title XII (called "Income-Tax Amendments").

(b) Such parts of Acts shall remain in force for the assessment and collection of all taxes which have accrued thereunder, and for the imposition and collection of all penalties or forfeitures which have accrued and may accrue in relation to any such taxes, and except that the unexpended balance of any appropriation heretofore made and now available for the administration of any such part of an Act shall be available for the administration of this Act or the corresponding provision thereof: *Provided*, That, except as otherwise provided in this Act, no taxes shall be collected under Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917, or Title I or II of the Revenue Act of 1917, in respect to any period after December 31, 1917: *Provided further*, That the assessment and collection of all estate taxes, and the imposition and collection of all penalties or forfeitures, which have accrued under Title II of the Revenue Act of 1916 as amended by the Act entitled "An Act to provide increased revenue to defray the expenses of the increased appropriations for the Army and Navy and the extensions of fortifications, and for other purposes," approved March 3, 1917, or Title IX of the Revenue Act of 1917, shall be according to the provisions of Title IV of this Act. In the case of any tax imposed by any part of an Act herein repealed, if there is a tax imposed by this Act in lieu thereof, the provision imposing such tax shall remain in force until the corresponding tax under this Act takes effect under the provisions of this Act.

Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917 shall remain in force for the assessment and collection of the income tax in Porto Rico and the Philippine Islands, except as may be otherwise provided by their respective legislatures.

VALIDATING PROVISION.

SEC. 1402. That if any clause, sentence, paragraph, or part of this Act shall for any reason be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder of this Act, but shall be confined in its operation to the clause, sentence, paragraph, or part thereof directly involved in the controversy in which such judgment has been rendered.

CITATION OF ACT.

SEC. 1405. That this Act may be cited as the "Revenue Act of 1918."

INSPECTION OF GOVERNMENT CONTRACTS.

SEC. 1408. That every person who on or after April 6, 1917, entered into any contract, undertaking, or agreement with the United States, or with any department, bureau, officer, commission, board, or agency under the United States or acting in its behalf, or with any other person having contract relations with the United States, for the performance of any work or the supplying of any materials or property for the use of or for the account of the United States, shall, within thirty days after a request of the Commissioner therefor, file with the Commissioner a true and correct copy of every such contract, undertaking, or agreement.

Whoever fails to comply with such request of the Commissioner shall be guilty of a misdemeanor and shall be punished by a fine of not more than $1,000, or by imprisonment for not more than one year, or both.

The Commissioner shall (when not violative of the technical military or naval secrets of the Government) have access to all information and data relating to any such contract, undertaking, or agreement, in the possession, control or custody of any department, bureau, board, agency, officer or commission of the United States, and may call upon any such department, bureau, board, agency, officer or commission for a full statement and description of any allowance for amortization, obsolescence, depreciation or loss, or of any valuation, appraisal, adjustment or final settlement, made in pursuance of any such contract, undertaking, or agreement.

AUTHORITY FOR REGULATIONS.

SEC. 1309. That the Commissioner, with the approval of the Secretary, is hereby authorized to make all needful rules and regulations for the enforcement of the provisions of this Act.

ART. 1800. **Promulgation of regulations.**—In pursuance of the statute the foregoing regulations are hereby made and promulgated and all rulings inconsistent herewith are hereby revoked.

WM. M. WILLIAMS,
Commissioner of Internal Revenue.

Approved January 28, 1921:
D. F. HOUSTON,
Secretary of the Treasury.

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86	213 (b)	3242	6
87	213 (b)	3206	6
91	213 (c)	3287	7
92	213 (c)	3287	7
134	214 (a) 3	3316	7
134 (1)	214 (a) 3	3411	7
141	214 (a) 4 to 6	3209	9
142	214 (a) 4 to 6	3538	10
143	214 (a) 4 to 6	3206	10
144	214 (a) 4 to 6	3206	11
153	214 (a) 7	3265	11
251	214 (a) 11	3490	11
307	216	3290	12
312	217	3155	13
313	217	3155	14
314	217	3155	14
315	217	3155	15
401	223	3138	15
404	223	3268	15
442	227	3454	15
515	231	3179	16
545	233	3206	17
549	233	3153	17
562	234	3215	18
563	234	3206	19
732	302	3245	19
733	302	3245	19
831	326	3220	19
831	326	3243	19
836	326	3367	20
870	326	3153	22
912	328	3235	22
913	328	3235	22
941	331	3259	23
1001	250	3136	23
1009	250	3126	24
1013	250	3229	24
1032	252	3251	25
1035	252	3154	25
1035–1036	252	3260	25–28
1073	256	3210	28
1091	257	3277	29
1091 (a)	257	3188	34
1092–1093	257	3277	35
1509	1	3287	35
1543	201	3206	35
1547	201	3206	36
1547 (4)	201	3238	37
1548	201	3206	37
1549	201	3206	37
1561	202	3206	38
1561	202	3393	38
1562	202	3206	42
1564	202	3206	42
1565	202	3206	43
1566	202	3206	43
1568	202	3206	44
1569	202	3206	45
1570	202	3206	45
1581	203	3296	46
1582	203	3296	46
1583	203	3296	48
1584	203	3296	48
1585	203	3296	49
1586	203	3399	50
1587	203	3296	51
1588	203	3296	52
1721	1313	3250	52
1731–1732	1314	3280	52–55
1800	1309	3240	55

TREASURY DECISIONS

AMENDING OR RELATING TO REGULATIONS 45.

ART. 39. **Sale of stock and rights.**—When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots can not be determined, the stock sold shall be charged against the earliest purchases of such stock. The excess of the amount realized on the sale over the cost of the stock will constitute gain. However, the gain which is taxable in the case where the stock was acquired before March 1, 1913, when its fair market value as of that date is in excess of its cost, is the excess of the amount realized by the sale over such value. No gain is recognized when stock is sold at more than its cost but at less than its fair market value as of March 1, 1913. In the case of stock in respect of which any stock dividend was paid, the cost of each share of such stock shall be ascertained as specified in article 1547. Where common stock is received as a bonus with the purchase of preferred stock or bonds, the total purchase price shall be fairly apportioned between such common stock and the securities purchased, for the purpose of determining the portion of the cost attributable to each class of stock or securities, but if that should be impracticable in any case, no profit on any subsequent sale of any part of the stock or securities will be realized until out of the proceeds of sales shall have been recovered the total cost. See article 1565 as amended. Where a corporation issues to its stockholders the right to subscribe to its stock, the value of the right does not constitute taxable income to the stockholder, but gain may be derived or loss sustained by the stockholder from the sale of such right. The amount of taxable gain derived or deductible loss sustained from the sale by a stockholder of the right to subscribe or from the sale of the stock with respect to which the right is issued shall be determined as provided in article 1561 as amended, after the cost or both the cost and fair market value as of March 1, 1913, if acquired prior thereto of both the old shares and the right is determined in accordance with the following rule:

Where the right issued relates to new stock of substantially the same character or preference as the stock with respect to which the right is issued, the cost of each share of the old stock and the right to subscribe to each share of the new (or, if acquired prior to March 1, 1913, the fair market value as of that date) will be the quotient of the cost (or such fair market value of the old shares of stock), plus the subscription price of the new shares of stock, divided by the sum of the number of the old shares and the number of new shares covered by the right. In computing the gain from the sale of the right in accordance with article 1561 the price for which sold shall be considered the sum of the subscription price of the new shares and the selling price of the right. The above rule for computing the gain from the sale of the right to subscribe to stock is subject to the limitation that the gain so computed shall not exceed the amount for which the right is sold; in any case in which this limitation is applied the gain or loss from the subsequent sale of the stock with respect to which the right was issued shall be determined as if no right to subscribe had been issued with respect to it. Where the stockholder exercises his right to subscribe to new stock of substantially the same character or preference as the stock with respect to which the right is issued, the cost of the old and new shares (or, if acquired prior to March 1, 1913, the fair market value as of that date) will be the quotient of the cost of the old shares, plus the subscription price of the new shares, divided by the total number of the old and new shares. Where the right issued deals with stock in whole or in part of a character or preference materially different from the stock with respect to which the right is issued, or where the stock with respect to which the right is issued was purchased at different times and at different prices, and the identity of the lots can not be determined, or where the stock with respect to which the right is issued was purchased at different times and at different prices and the stock right issued with respect to such stock can not be identified as having been issued with respect to any particular lot of such stock, the computation of the gain from the sale of the old shares or the right in cases where the right is sold or from the sale of the old or new shares in cases where the right is exercised shall be based upon and shall be in accordance with the principles laid down in article 1547 as amended with respect to the computation of the gain or loss from the sale of stock received as a stock dividend. (T. D. 3402; approved October 18, 1922, amending art. 39, Reg. 45, as amended by T. D. 3206.)

ART. 40. **Sale of patents and copyrights.**—A taxpayer disposing of patents or copyrights by sale should determine the profit or loss arising therefrom by computing the difference between the selling price and the cost. The taxable income in the case of patents or copyrights acquired prior to March 1, 1913, should be ascertained in accordance with the provisions of article 1561 as amended. The profit or loss thus ascertained should be increased or decreased, as the case may be, by the amounts deducted on account of depreciation of such patents or copyrights since February 28, 1913, or since the date of acquisition if subsequent thereto. See article 167. (T. D. 3206; approved July 28, 1921, amending art. 40, Reg. 45.)

ART. 41. **Sale of good will.**—Any profit or loss resulting from a sale of good will can be taken only when the business, or a part of it, to which the good will attaches is sold, in which case the profit or loss will be determined upon the basis of the cost of the assets, including good will. If the good will was acquired prior to March 1, 1913, the taxable gain or deductible loss should be ascertained in accordance with the provisions of article 1561 as amended. If nothing was paid for good will acquired after February 28, 1913, no deductible loss with respect thereto is possible, although on the other hand, upon the sale of the business there may be a profit. It is immaterial that good will may never have been carried on the books as an asset, but the burden of proof is on the taxpayer to establish the cost or fair market value on March 1, 1913, of the good will sold. See article 163. (T. D. 3206; approved July 28, 1921, amending art. 41, Reg. 45.)

ART. 43. **Sale of real estate in lots.**—Where a tract of land is purchased with a view to dividing it into lots or parcels of ground to be sold as such the cost shall be equitably apportioned to the several lots or parcels and made a matter of record on the books of the taxpayer, to the end that any gain derived from the sale of any such lots or parcels which constitutes taxable income, may be returned as income for the year in which the sale was made. This rule contemplates that there will be a measure of gain or loss on every lot or parcel sold, and not that the capital invested in the entire tract shall be extinguished before any taxable income shall be returned. The sale of each lot or parcel will be treated as a separate transaction and the gain or loss will be accounted for as provided in article 1561 as amended. (T. D. 3206; approved July 28, 1921, amending art. 43, Reg. 45.)

ART. 48. **Improvements by lessees.**—When buildings are erected or improvements are made by a lessee in pursuance of an agreement with the lessor, and such buildings or improvements are not subject to removal by the lessee, the lessor receives income at the time when such buildings or improvements are completed to the extent of the fair market value of such buildings or improvements subject to the lease. This amount would ordinarily be the difference between the value of the land free from the lease without such improvements and the value of the land subject to the lease with such improvements. If, for any other reason than a bona fide purchase from the lessee by the lessor, the lease is terminated, so that the lessor comes into possession and control of the property prior to the time originally fixed for the termination of the lease, the lessor receives additional income for the year in which the lease is so terminated to the extent that the value of such buildings or improvements when he became entitled to such possession exceeds the fair market price or value thereof to him as determined when the same completed became part of the realty. No appreciation in value due to causes other than the premature termination of the lease shall be included. Conversely, if the buildings or improvements are destroyed prior to the expiration of the lease, the lessor is entitled to deduct as a loss of the year when such destruction takes place the fair market price or value of such buildings or improvements subject to the lease as determined when the same completed became a part of the realty, less any salvage value subject to the lease, to the extent that such loss was not compensated by insurance. If the buildings or improvements destroyed were acquired prior to March 1, 1913, the deduction shall be based on the cost or the value subject to the lease, as of that date, whichever is lower, less any salvage value subject to the lease, to the extent that such loss was not compensated by insurance. See articles 109 and 164. (T. D. 3206; approved July 28, 1921, amending art. 48, Reg. 45.)

ART. 49. **Compensation for loss.**—In the case of property which has been lost or destroyed in whole or in part through fire, storm, shipwreck, or other casualty, or where the owner of property has lost or transferred title by reason of the exercise of the power of requisition or eminent domain, including cases where a voluntary transfer or conveyance is induced by reason of the fact that a technical requisition or condemnation proceeding is imminent, that amount received by the owner as compensation for the property which is in excess of the cost of the property constitutes gain. However, the gain which is taxable in the case where the property was acquired before March 1, 1913, and its fair market value as of that date was greater than its cost, is the excess over such value of the amount received. No taxable gain results when the amount received is more than the cost but less than the fair market value of the property as of March 1, 1913. In any case proper provision shall be made for depreciation to the date of the loss, damage, or transfer. The transaction is not regarded as completed at this stage, however, if the taxpayer proceeds immediately in good faith to replace the property, or if he makes application to establish a replacement fund as provided in the following article. In such a case, the gain, if any, is measured by the excess of the amount received over the amount actually and reasonably expended to replace or restore the property substantially in kind, exclusive of any expenditures for additions or betterments. The new or restored property effects a replacement in kind only to the extent that it serves the same purpose as the property which it replaces without added capacity or other element of additional value. Such new or restored property shall not be valued in the accounts of the taxpayer at an amount in excess of the cost, or its value as of March 1, 1913, if acquired before that date and such value as of such date is higher than the cost (after making proper provision in either case for depreciation to the date of the loss, damage, or transfer), of the original property, plus the cost of any actual additions and betterments. If the taxpayer does not elect to replace or restore the property, the transaction will then be deemed to be completed and the gain shall be the difference between the cost of the property and the amount of the compensation received. If such property was acquired prior to March 1, 1913, and its fair market value as of that date was greater than such cost, the taxable gain shall be the excess over such fair market value of the amount of the compensation received. However, no gain shall be taxable when the amount received is more than the cost of such property but less than its fair market value as of March 1, 1913. In any event proper provision must be made for depreciation to the date of the loss, damage, or transfer. See article 141. Articles 49 and 50 have no application to property which is voluntarily sold or disposed of. (T. D. 3206; approved July 28, 1921, amending art. 49, Reg. 45.)

ART. 52. **When included in gross income.**—Gains, profits, and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included when they accrue to him in accordance with the approved method of accounting followed by him. See articles 21–24. Lands which are received as compensation for services in one year, the title to which is disputed and in a later year adjudged to be valid, constitute income to the grantee in the former year. On the other hand, a person may sue in one year on a pecuniary claim or for property, but money or property recovered on a judgment therefor rendered in a later year would be income in that year, assuming that it would have been income in the earlier year if then received. This is true of a recovery for patent infringement. Bad debts or accounts charged off subsequent to February 28, 1913, because of the fact that they are determined to be worthless, which are subsequently recovered, whether or not by suit, constitute income for the year in which recovered. For the rule to be followed in the case of bad debts charged off as worthless prior to March 1, 1913, and recovered subsequent to that date, see article 87 as amended by T. D. 3206, approved July 28, 1921. See also articles 111 and 151. In view of the unusual conditions prevailing at the close of the year 1918 it is recognized that many items of gross income, such as claims for compensation under canceled contracts, together with claims against contracting departments of the Government for amortization and other matters, while properly constituting gross income for the taxable year 1918, were undecided and not sufficiently definite in amount to be reported in the original return for that year. In every such case the taxpayer should attach to his return a full statement of such pending claims and other matters, and when the correct amount of such items is ascertained an amended return for the taxable year 1918 should be filed. (T. D. 3247; approved November 17, 1921, amending art. 52, Reg. 45.)

ART. 83. **Income of foreign Governments.**—The exemption of foreign Governments applies also to their political subdivisions. Any income collected by foreign Governments from investments in the United States in stocks, bonds, or other domestic securities, which are not actually owned by but are loaned to such foreign Governments, is subject to tax. The income from investments in the United States in bonds and stocks and from interest on bank balances received by ambassadors and ministers accredited to the United States and the fees of foreign consuls, are exempt from tax but income of such foreign officials from any business carried on by them in the United States would be taxable. As under international law, the benefits and immunities of ambassadors and ministers of foreign countries extend to the members of their households, including attachés, secretaries, and servants, the foregoing provision is likewise applicable to the wives and minor children of foreign ambassadors and ministers and the members of their households. The compensation of citizens of the United States who are officers or employees of a foreign Government is, however, not exempt from tax. (T. D. 3266; approved December 21, 1921, amending art. 83, Reg. 45.)

ART. 86. **Compensation of soldiers and sailors.**—See T. D. 3242 (C. B. 5, p. 114) as to personnel of Public Health Service.

ART. 87. **Income accruing prior to March 1, 1913.**—Any liquidated claim existing unconditionally on March 1, 1913, and then assignable, whether presently payable or not and held by a taxpayer prior to March 1, 1913, whether evidenced by writing or not; and all interest which had accrued thereon before that date, do not constitute taxable income, although actually recovered or received subsequent to such date. Interest accruing on or after that date is taxable income. Where an interest-bearing claim held on February 28, 1913, is paid in whole or in part after that date, any gain derived from the payment of the claim is taxable. The amount of such gain is the excess of the proceeds of the claim (both principal and interest) exclusive of any interest accrued since February 28, 1913, already returned as income, over the cost thereof (both principal and interest then accrued). However, the gain which is taxable where the fair market value of the claim as of March 1, 1913, is greater than the cost thereof, is the excess of the amount received over such value. No gain results where the amount received from the claim is more than the cost thereof but less than its fair market value as of March 1, 1913. In the case of an insurance policy its surrender value as of March 1, 1913, may be used as a basis for the purpose of ascertaining the gain derived from the sale or other disposition of such property. Where services were rendered prior to March 1, 1913, but paid for thereafter, the amount received is taxable income to the extent of the excess of such amount over the fair market value on March 1, 1913, of the principal of the claim and any interest which had then accrued. Interest does not include dividends on corporate stock. See section 201 of the statute, and articles 1541–1549 as amended. (T. D. 3206; approved July 28, 1921, amending art. 87, Reg. 45.)

ART. 91. **Gross income of nonresident alien individuals.**—In the case of nonresident alien individuals "gross income" means only the gross income from sources within the United States. This includes interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, dividends from resident corporations, amounts received representing profits on the manufacture and disposition of goods within the United States, rentals and royalties from property and income from business carried on in the United States, interest on deposits in banks located within the United States, and income from services rendered or labor performed within the United States. Interest on obligations and dividends on stock of a corporation organized within the United States are included, even though such corporation owns no property and does no business in the United States. Interest on obligations and dividends on stock of resident foreign corporations are also included. For what is a resident corporation, see article 1509. As to the gross income of foreign corporations, see section 233 (*b*) of the statute and article 550. (T. D. 3287; approved February 18, 1922, amending art. 91, Reg. 45.)

ART. 92. **Income of nonresident alien individuals not subject to tax.**—Salaries, wages, commissions, and rents paid by domestic business enterprises to nonresident alien employees for services rendered entirely in a foreign country or for property located in a foreign country are not subject to tax as income from a source within the United States. The tax does not apply to charter money or freight payments received by a foreign owner in regard to a vessel operated between the United States and foreign ports if the person receiving the income maintains no regular agency in the United States and is not doing business in the United States. Compensation received by nonresident alien munitions inspectors and purchasing agents from foreign Governments is not subject to the tax. (T. D. 3287; approved February 18, 1922, amending art. 92, Reg. 45.)

ART. 134. **Federal estate and State inheritance taxes.**—Federal estate taxes paid or accrued during the taxable year are an allowable deduction from the gross income of the estate in computing the net income thereof subject to tax. The whole amount of such taxes, irrespective of when paid, is deemed to have accrued on the due date thereof, namely, one year after the decedent's death (sec. 406, Title IV, Revenue Act of 1921), and, if the accounts of the estate are kept on an accrual basis, are deductible from gross income of the taxable year in which such due date falls, or for the taxable year in which paid, if paid before the due date. If the accounts are kept on the basis of cash receipts and disbursements, deduction may be taken from gross income of the taxable year or years in which the payment or payments may have been made. (T. D. 3411; approved November 24, 1922, amending first paragraph of art. 134, Reg. 45, as amended by T. D. 3316.)

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

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

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

The accrual dates of such taxes shall be the due date thereof except as otherwise provided by the law of the jurisdiction imposing them.

Where deduction is claimed of any such taxes, the amount thereof and the name of the State, Territory, or possession of the United States, or foreign country, by which they have been imposed shall be stated in the return. (T. D. 3316; approved April 5, 1922, amending art. 134, Reg. 45.)

ART. 141. **Losses.**—Losses sustained during the taxable year and not compensated for by insurance or otherwise are fully deductible (except by nonresident aliens) if (*a*) incurred in a taxpayer's trade or business, or (*b*) incurred in any transaction entered into for profit, or (*c*) arising from fires, storms, shipwreck, or other casualty, or theft. They must usually be evidenced by closed and completed transactions. In the case of the sale of assets the loss will be the difference between the cost thereof less depreciation sustained since acquisition and the price at which sold or disposed of. However, the loss which is deductible in the case where such property was acquired before March 1, 1913, and where its fair market value on that date was less than the cost thereof, is the difference between such value (less depreciation) and the price at which sold or disposed of. No loss is recognized in the case of property sold at less than cost minus depreciation but for more than its fair market value as of March 1, 1913. See section 202 of the statute and articles 39–46 and 1561 as amended. When loss is claimed through the destruction of property by fire, flood, or other casualty, the amount deductible will be the difference between the cost of the property and the salvage value thereof, after deducting from such cost the amount, if any, which has been or should have been set aside and deducted in the current year and previous years from gross income on account of depreciation and which has not been paid out in making good the depreciation sustained. In the case of property acquired before March 1, 1913, when the fair market value as of that date is lower than the cost, the deductible loss is the difference between such value and the salvage value thereof after deducting from the value as of March 1, 1913, the amount, if any, which has been or should have been set aside and deducted in the current year and previous years from gross income on account of depreciation and which has not been paid out in making good the depreciation sustained. No loss is recognized where the salvage value is less than the cost but more than the depreciated value of such property as of March 1, 1913. In any event the loss should be reduced by the amount of any insurance or other compensation received. See articles 49 and 50. A loss on the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit. Losses in illegal transactions are not deductible. Where a person gives away property, or is divested thereof by death, no realization of loss results therefrom.

(T. D. 3209; approved August 4, 1921, amending art. 141, Reg. 45, as amended by T. D. 3206.)

ART. 142. **Voluntary removal of buildings.**—Loss due to the voluntary removal or demolition of old buildings, the scrapping of old machinery, equipment, etc., incident to renewals and replacements will be deductible from gross income in a sum representing the difference between the cost of such property demolished or scrapped or the March 1, 1913, value thereof if acquired prior to that date, whichever is lower, and the amount of a reasonable allowance for the depreciation which the property had undergone prior to its demolition or scrapping; that is to say, the deductible loss is only so much of the original cost or the March 1, 1913, value, if acquired prior to that date, whichever is lower, less salvage, as would have remained unextinguished had a reasonable allowance been charged off for depreciation during each year prior to its destruction. When a taxpayer buys real estate upon which is located a building which he proceeds to raze with a view to erecting thereon another building, it will be considered that the taxpayer has sustained no deductible loss by reason of the demolition of the old building, and no deductible expense on account of the cost of such removal, the value of the real estate, exclusive of old improvements, being presumably equal to the purchase price of the land and building plus the cost of removing the useless building. (T. D. 3538; approved December 11, 1923, amending art. 142, Reg. 45.)

ART. 143. **Loss of useful value.**—When, through some change in business conditions, the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in such business, he may claim as a loss for the year in which he takes such action the difference between the cost, or, if acquired prior to March 1, 1913, the cost or fair market price or value as of that date, whichever is lower, of any assets so discarded (less any depreciation sustained) and its salvage value remaining. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property has been prematurely discarded, as, for example, where an increase in the cost of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. But see articles 181–189. (T. D. 3206; approved July 28, 1921, amending art. 143, Reg. 45.)

ART. 144. **Shrinkage in securities and stocks.**—A person possessing securities, such as stocks and bonds, can not deduct from gross income any amount claimed as a loss on account of shrinkage in value of such securities through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the securities mature or are disposed of. See, however, article 154. In the case of banks or other corporations which are subject to supervision by State or Federal authorities, and which in obedience to the orders of such supervisory officers charge off as losses amounts representing an alleged shrinkage in the value of property, the amounts so charged off do not constitute allowable deductions. However, if stock of a corporation becomes worthless its cost, or if acquired prior to March 1, 1913, its cost or fair market value as of that date, whichever is lower, may be deducted by the owners in the taxable year in which the stock becomes worthless, provided a satisfactory showing of its worthlessness be made as in the case of bad debts. See article 151. (T. D. 3206; approved July 28, 1921, amending art. 144, Reg. 45.)

ART. 153. **Uncollectible deficiency upon sale of mortgaged or pledged property.**—Where mortgaged or pledged property is sold, in the manner prescribed by law to satisfy the debt secured, for less than the debt, and the mortgagee or pledgee at that time or thereafter ascertains that the portion of the indebtedness remaining unsatisfied after such sale is uncollectible, and charges it off, he may deduct such amount as a bad debt for the taxable year in which it is ascertained to be worthless and charged off. Accrued interest may be included as part of the deduction only when it has previously been returned as income. (T. D. 3265; approved December 21, 1921, amending art. 153, Reg. 45.)

ART. 251. **Charitable contributions.**—Contributions or gifts within the taxable year are deductible to an aggregate amount not in excess of 15 per cent of the taxpayer's net income, including such payments, if made (*a*) to corporations or associations of the kind exempted from tax by subdivision (6) of section 231 of the statute or (*b*) to the special fund for vocational rehabilitation under the Vocational Rehabilitation Act of June 27, 1918. For a discussion of what corporations and associations are included within (*a*) see article 517. A gift to a common agency (as a war chest) for several such corporations or associations is treated like a gift direct to them. In connection with claims for this deduction there shall be stated on returns of income the name and address of each organization to which a gift was made and the approximate date and the amount of the gift in each case. Where the gift is other than money, the basis for calculation of the amount thereof shall be the fair market value of the property at the time of the gift. A gift of real estate to a city to be maintained perpetually as a public park is not an allowable deduction. The proportionate share of contributions made by a partnership to corporations or associations of the kind included in (*a*) above and to the special fund for vocational rehabilitation specified in (*b*) may be claimed as deductions in the personal returns of the partners to an amount which, added to the amount of such contributions made by the partner individually, is not in excess of 15 per cent of the partner's net income computed without the benefit of the deduction for such contributions. However, the contributions made by the partnership shall not be deducted from its gross income in ascertaining the amount of its net income to be reported on Form 1065 (revised). See article 321. This article does not apply to gifts by estates and trusts or corporations. See section 219 of the statute and articles 561 and 562. (T. D. 3490; approved June 16, 1923, amending art. 251, Reg. 45.)

ART. 307. **When nonresident alien individual entitled to personal exemption.**—(*a*) The following is an incomplete list of countries which either impose no income tax or in imposing an income tax allow both a personal exemption and a credit for dependents which satisfy the similar credit requirement of the statute: Argentina, Bahama, Barbados, Basutoland, Bechuanaland Protectorate, Belgium, Bermuda, Bolivia, Bosnia, Brazil, British Guiana, British Honduras, Bukowina, Bulgaria, Canada, Carniola, Ceylon, Chile, China, Colombia, Cuba, Cyprus, Czechoslovakia, including Bohemia, Moravia, and Slovakia, Dalmatia, Denmark, Ecuador, Egypt, Falkland Islands, Fiji Islands, France, Galicia, Gambia, Germany, Gibraltar, Gold Coast, Goritz, Gradisca, Greece, Grenada, Guatemala, Herzegovina, Hongkong, Istria, Jamaica, Kenya, Luxemburg, Malay States, Malta, Mauritius, Mexico, Montenegro, Montserrat, Morocco, Newfoundland, Nicaragua, Nigeria, Northern Rhodesia, Norway, Nyasaland Protectorate, Panama, Paraguay, Persia, Peru, Porto Rico, Portugal, Rumania, St. Kitt-Nevis, St. Helena, Santo Domingo, Serbia, Siam, Sierra Leone, Silesia, Somaliland Protectorate, Spain, Swaziland, Switzerland, Trieste, Uganda Protectorate, Union of South Africa, Venezuela, Virgin Islands (British), Weihaiwei, Western Pacific Islands, Zanzibar Protectorate. (*b*) The following is an incomplete list of countries which in imposing an income tax allow a personal exemption which satisfies the similar credit requirement of the statute, but do not allow a credit for dependents: Bachka, Banat of Temesvar, Croatia, Finland, India, Italy, Salvador, Slavonia, Transylvania. (*c*) The following is an incomplete list of countries which in imposing an income tax do not allow to citizens of the United States not residing in such country either a personal exemption or a credit for dependents and therefore fail entirely to satisfy the similar credit requirements of the statute: Australia, Austria, including Carinthia, Lower Austria, Salzberg, Styria, Tyrol, Upper Austria and Vienna, Costa Rica, Dutch Guiana, Great Britain and Ireland, Japan, the Netherlands, New Zealand, Trinidad, Sweden. The former names of certain of these territories are here used for convenience, in spite of an actual or possible change in name or sovereignty. A nonresident alien individual who is a citizen or subject of any country in the first list is entitled for the purpose of the normal tax to such credit for personal exemption and for dependents as his family status may warrant. If he is a citizen or subject of any country in the second list he is entitled to a credit for personal exemption, but to none for dependents. If he is a citizen or subject of any country in the third list he is not entitled to credit for either personal exemption or for dependents. If he is a citizen or subject of a country which is in none of the lists, then to secure credit for either a personal exemption or for dependents he must prove to the satisfaction of the commissioner that his country does not impose an income tax or that in imposing an income tax it grants the similar credit required by the statute. (T. D. 3290; approved February 21, 1922, amending art. 307, Reg. 45.)

ART. 312. **Who is a nonresident alien individual.**—A "nonresident alien individual" means an individual (*a*) whose residence is not within the United States and (*b*) who is not a citizen of the United States. An alien actually present in the United States who is not a mere transient or sojourner is a resident of the United States for purposes of the income tax. Whether he is a transient or not is determined by his intentions with regard to his stay and the length and nature of his stay. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient. If he lives in the United States and has no definite intention as to his stay, he is a resident. One who comes to the United States for a definite purpose which in its nature may be promptly accomplished is a transient; but if his purpose is of such a nature that an extended stay may be necessary for its accomplishment, and to that end the alien makes his home temporarily in the United States, he becomes a resident, though it may be his intention at all times to return to his domicile abroad when the purpose for which he came has been consummated or abandoned. (T. D. 3155; approved April 11, 1921, amending art. 312, Reg. 45.)

ART. 313. **Proof of residence of alien.**—The following rules of evidence shall govern in determining whether or not an alien within the United States has acquired residence therein within the meaning of the Revenue Act. An alien, by reason of his alienage, is presumed to be a nonresident alien. Such presumption may be overthrown (1) in the case of an alien who presents himself for determination of tax liability prior to departure for his native country, by (*a*) proof that the alien, at least six months prior to the date he so presents himself, has filed a declaration of his intention to become a citizen of the United States under the naturalization laws, (*b*) proof that the alien, at least six months prior to the date he so presents himself, has filed Form 1078 or its equivalent, or (*c*) proof of acts and statements of the alien showing a definite intention to acquire residence in the United States or showing that his stay in the United States had been of such an extended nature as to constitute him a resident; (2) in all other cases by (*a*) proof that the alien has filed a declaration of his intention to become a citizen of the United States under the naturalization laws, (*b*) proof that the alien has filed Form 1078 or its equivalent, or (*c*) proof of acts and statements of an alien showing a definite intention to acquire residence in the United States or showing that his stay in the United States has been of such an extended nature as to constitute him a resident. In any case in which an alien seeks to overcome the presumption of nonresidence under (1) (*c*) or (2) (*c*) above, if the officer who examines the alien is in doubt as to the facts, such officer may, to assist him in determining the facts, require an affidavit or affidavits setting forth the facts relied upon, executed by some creditable person or persons, other than the alien and members of his family, who have known the alien at least six months prior to the date of execution of the affidavit or affidavits. (T. D. 3155; approved April 11, 1921, amending art. 313, Reg. 45.)

ART. 314. **Loss of residence by alien.**—An alien who has acquired residence in the United States retains his status as a resident until he abandons the same and actually departs from the United States. An intention to change his residence does not change his status as a resident alien to that of a nonresident alien. Thus an alien who has acquired a residence in the United States is taxable as a resident for the remainder of his stay in the United States. The status of an alien on the last day of his taxable year or period determines his liability to tax for such year or period as a resident or nonresident. See articles 305 and 306. (T. D. 3155; approved April 11, 1921, amending art. 314, Reg. 45.)

Art. 315. **Duty of employer to determine status of alien employee.**—If wages are paid to aliens without withholding the tax, except as permitted in article 316, the employer should be prepared to prove the status of the alien as provided in the foregoing articles. An employer may rely upon the evidence of residence afforded by the fact that an alien has filed Form 1078 or an equivalent certificate of the alien establishing residence. An employer who seeks to account for failure to withhold in the past, if he had not at the time secured Form 1078 or its equivalent, is permitted to prove the former status of the alien by any material evidence. (T. D. 3155; approved April 11, 1921, amending art. 315, Reg. 45.)

Art. 401. **Individual returns.**—See T. D. 3138 (C. B. 4, p. 238) as to community property.

Art. 404. **Return of income of nonresident alien.**

Section 221 of the Revenue Act of 1921 provides for withholding of a tax equal to 8 per cent from the annual or periodical gains, profits, or income of a partnership composed in whole or in part of nonresident aliens. (See sec. 221.) However, in the case of a partnership having an office or place of business in the United States, withholding will not be required even though one or more of the members thereof is a nonresident alien; the partnership, however, as agent of the nonresident alien member or members, shall file a return of the income of such nonresident alien member or members in accordance with the provisions of article 404 of Regulations 45, and the corresponding article of Regulations 62, to be promulgated under the Revenue Act of 1921. (T. D. 3268; approved January 5, 1922, relating to art. 404, Reg. 45.)

Art. 442. **Time for filing return upon death, or termination of trust.**—After his appointment and qualification, an executor or administrator may immediately file a return for the decedent without waiting for the close of the taxable year. Upon the completion of the administration of an estate and final accounting, an executor or administrator may immediately file a return of income of the estate for the fractional part of the taxable year in which the administration was closed, attaching to the return a certified copy of the order for his discharge. Similarly upon the termination of a trust, the trustee may immediately make a return without waiting for the close of the taxable year. Any income return required to be filed for a decedent, or for the fractional part of a year in which an estate is closed or a trust terminated, is due on the fifteenth day of the third month following the close of the taxable year during which the decedent dies, the estate is closed, or the trust is terminated, which date shall also be the due date for payment of the first installment of the tax. The payment of the tax before the end of the taxable year in such circumstances does not relieve the taxpayer from liability for any additional tax which might subsequently be imposed upon income of the taxable year. See section 250(*d*) and article 1012.

The domiciliary representative is required to include in the return rendered by him as such domiciliary representative the entire income of the estate. Consequently the only return required to be filed by the ancillary representative is on Form 1041, which shall be filed with the collector for his district and shall show the name and address of the domiciliary representative, the amount of gross income received by the ancillary representative, and the deductions to be claimed against such income including any amount of income properly paid or credited by the ancillary representative to any legatee, heir, or other beneficiary. If the ancillary representative for the estate of a nonresident alien is a citizen or resident of the United States, and the domiciliary representative is a nonresident alien, such ancillary representative is required to render the return otherwise required of the domiciliary representative. (T. D. 3454; approved March 17, 1923, amending art. 442, Reg. 45.)

ART. 515. **Building and loan associations and cooperative banks.**—In general, a building and loan association entitled to exemption is one organized pursuant to the laws of the United States, or some State or Territory thereof, which accumulates funds for the primary business of making loans to its members for the purpose of building or acquiring homes, and in which the members of the association share in the profits on substantially the same footing. It is essential that the association should be (*a*) mutual; (*b*) organized and operated for the accumulation of funds to be loaned primarily to members for home building. Where a building and loan association has no other features which render it liable to income tax it will ordinarily not be subject to tax merely because—

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

(2) It borrows large sums of money (accepting deposits is considered as borrowing), which it uses primarily for loans to members, the dues paid by members being entirely inadequate for this purpose.

(3) In times of small demand it loans considerable sums to nonmembers from or invests association funds which would otherwise lie idle and unproductive.

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

Where, however, the facts show that a building and loan association is borrowing large sums of money from nonmembers with no reference to the borrowing needs of its members, and is in turn loaning these sums to nonmembers, the number of depositors being disproportionate to the number of members, and the amounts loaned to nonmembers being disproportionate to the amount loaned to members, such association will be deemed to be taxable and will be granted exemption only upon a satisfactory showing to the commissioner that it is, in fact, a bona fide building and loan association within the meaning of this article.

Cooperative banks without capital stock organized and operated for mutual purposes and without profit are exempt. Credit unions, such as those organized under the laws of Massachusetts, are in substance the same as cooperative banks, and when organized and operated without capital stock, for mutual purposes and without profit, are likewise exempt. (T. D. 3179; approved June 16, 1921, amending art. 515, Reg. 45.)

ART. 545. **Sale of capital assets.**—Where property is acquired and later sold for a higher price the gain on the sale is income. If, however, the property was acquired before March 1, 1913, only such portion of the gain as accrued subsequently to February 28, 1913, is taxable. Where, then, a corporation sells its capital assets in whole or in part it shall include in its gross income for the year in which the sale was made the amount of the excess of the sales price over the cost unless it acquired such assets prior to March 1, 1913, and the fair market value of such assets as of such date was in excess of the cost, in which case it shall include the excess of the amount of the sales price over such value. No gain or loss is recognized in case the assets are sold (*a*) at more than cost but at less than their fair market value as of March 1, 1913, or (*b*) at less than cost but at more than their fair market value as of March 1, 1913. In every case, however, in ascertaining the gain, the cost of the assets, or the fair market value as of March 1, 1913, of the assets acquired prior thereto, should first be reduced by the amount of any charges for depreciation, depletion, and other deductions which have been or should have been taken. If the purchaser takes over all the assets and assumes the liabilities, the amount so assumed is part of the purchase price. See also article 563 as amended. If the sale is made for stock of another corporation, the rules contained in section 202 of the statute and in articles 1561-1570 as amended are particularly applicable. (T. D. 3206; approved July 28, 1921, amending art. 545, Reg. 45.)

ART. 549. **Exclusions from gross income.**—A life insurance company shall not include in gross income such portion of any actual premium received from any individual policyholder as is paid back, or credited to, or treated as an abatement of premium of such policyholder within the taxable year.

"Paid back" means paid in cash.

"Credited to" means applied by way of credit so as to reduce the premium received on the policy for the taxable year. It includes dividends applied (*a*) directly to the payment of the premium for the taxable year; (*b*) to purchase additional paid-up insurance or annuities; or (*c*) to shorten the endowment or premium paying period; or (*d*) left with the company to accumulate at interest. It does not include the amount of divisible surplus annually ascertained and apportioned to deferred dividend policies.

"Treated as an abatement of premium" means of the premium for the taxable year.

Where the dividend paid back or credited to a policyholder is in excess of the premium received from such policyholder within the taxable year there may be excluded from gross income only the amount of the premium received, and where no premium is received from the policyholder within the taxable year the company is not entitled to exclude from its premiums received from other policyholders any amount on account of such dividend payment. (T. D. 3153; approved April 9, 1921, amending art. 549, Reg. 45.)

ART. 562. **Donations.**

In order to obviate the necessity of filing amended returns on the prescribed forms for the year 1918, corporations which, prior to the issuance of T. D. 2847, filed their completed returns and erroneously claimed therein deductions on account of contributions to the Red Cross and other recognized war organizations, are required to file with the collector of internal revenue within 30 days from date of this decision a supplemental return in the form of a statement under oath showing the amount of such deductions claimed, the amount of net income as reported and as corrected, and the amount of additional tax due. Payment of the total amount of additional tax shown to be due by such supplemental return must also be made within 30 days.

In cases where this procedure is followed, formal amended returns will not be required and the supplemental returns referred to when received by this office through the collector's office will be filed with the original returns.

Where in connection with any return for the year 1918 an audit of the books of the corporation has been made by the department and the amount of such contributions disclosed, the statement herein provided for need not be made.

Failure by a corporation to file a supplemental return as required will subject it to the penalties provided by section 3176, United States Revised Statutes. (T. D. 3215; approved August 16, 1921, relating to art. 562, Reg. 45.)

ART. 563. **Sale of capital stock, bonds, and capital assets.**—A corporation sustains no deductible loss from the sale of its capital stock. See article 542. If it sells its bonds at a discount, the amount of such discount is treated in the same way as interest paid, and if it retires its bonds at a price in excess of the issuing price, such excess may usually be deducted as expense. See articles 544 and 848 as amended. If a corporation sells its capital assets for less than their cost, the loss sustained is deductible unless the assets were acquired before March 1, 1913, and sold at less than cost, but at more than their fair market value as of March 1, 1913. The loss which is deductible in the case where assets acquired before March 1, 1913, are sold after that date at less than cost and less than their fair market value as of that date, and such value was less than cost, is the difference between such price or value and the amount realized by the sale or exchange. See article 545 as amended. (T. D. 3206; approved July 28, 1921, amending art. 563, Reg. 45.)

ART. 732. **Limitation when return for fractional part of year.**—When a return is rendered for a fractional part of a year, the limitation shall be computed in the same manner as if the period covered by the return were a full taxable year. (T. D. 3245; approved November 14, 1921, amending art. 732, Reg. 45.)

ART. 733. **Illustration of computation of limitation of tax.**—If in the illustration used in article 720 the invested capital had been $100,000 and the net income $80,000, the tax computed under section 301 (*a*) of the statute would be $56,200. Section 302 provides, however, that the tax under section 301 (*a*) shall not be more than 30 per cent of the net income in excess of $3,000 and not in excess of $20,000 plus 80 per cent of the net income in excess of $20,000. The tax at the 30 per cent rate will be $5,100 (art. 731) and the balance of the tax will be 80 per cent of $60,000 (the net income in excess of $20,000), or $48,000. The total tax will therefore be $5,100 plus $48,000, or $53,100. The tax under section 301 (*a*), amounting to $56,200, will accordingly be reduced to $53,100. (T. D. 3245; approved November 14, 1921, amending art. 733, Reg. 45.)

ART. 831. **Meaning of invested capital.**

An examination of income and excess-profits tax returns for 1917 and subsequent years has disclosed that many taxpayers have used appreciated and inflated values in determining invested capital shown in such returns contrary to section 207 of the Revenue Act of 1917 and section 326 of the Revenue Act of 1918.

This office has held consistently that the use of appreciated or inflated values in determining invested capital is not permissible, and this ruling has been sustained by the United States Supreme

Court in the case of the La Belle Iron Works *v.* The United States (41 Sup. Ct. 528; T. D. 3051).

All taxpayers who, in the preparation of their income and excess-profits tax returns for 1917 and subsequent years, have used appreciated or inflated values in determining the amount of their invested capital are required to file with the collector of internal revenue within 90 days from date of this decision amended returns for each of such years, in which the invested capital shall be computed strictly in accordance with the law and regulations and without the use of appreciated or inflated values. It is not required that such amended returns shall include the figures shown in the original returns which are unaffected by this decision. Only such figures as are necessary to show the correct values used in the computation of invested capital and such totals as are necessary to a redetermination of the tax need be shown. Payment of the additional tax shown to be due on such amended returns must also be made at the time the returns are filed.

Failure to file amended returns within the time specified will subject taxpayers to the penalties provided for in section 3176, United States Revised Statutes, as amended. (T. D. 3220; approved August 26, 1921, relating to art. 831, Reg. 45.)

Under the provisions of T. D. 3220, approved August 26, 1921, all taxpayers who, in the preparation of their income and profits tax returns for 1917 and subsequent years, have used appreciated or inflated values in determining the amount of their invested capital are required to file amended returns within 90 days from the date of that decision and make payment of the additional tax shown to be due.

In view of the fact that many taxpayers are unable to complete their returns by November 24, 1921, the last date under which amended returns may be filed, as provided by T. D. 3220, an extension of time up to and including January 15, 1922, is hereby granted within which to file such amended returns and make payment of the additional tax due. (T. D. 3243; approved November 14, 1921, relating to art. 831, Reg. 45.)

ART. 836. **Tangible property paid in; value in excess of par value of stock.**—The paid-in surplus allowed in any case is confined to the value definitely known or accurately ascertainable at the time the property is paid in. Evidence offered to support a claim for a paid-in surplus must be as of the date of the payment. It may consist among other things of (*a*) an appraisal of the property by disinterested authorities; (*b*) a certificate of the assessed value in the case of real estate, or (*c*) evidence of a market price in excess of the par value of the stock or shares. Opinion evidence, expert or otherwise, of the value of property as of a prior date will not be accepted.

Retrospective appraisals submitted in support of a claim for a paid-in surplus will not be accepted in any case where other reasonably satisfactory evidence is available and in any case will be accepted only after rigid scrutiny and will be followed only to the extent to which their reasonableness is fully established. The property which was paid in is the basis of the appraisal, and the appraisal must reconcile the accounts so as to reflect accurately the actual value on the date as of which the appraisal is made and the depreciation sustained. Proper consideration must in all cases be given to depreciation and the expired and remaining serviceable life of the property must be shown. To be acceptable retrospective appraisals must show: (1) The history of the business and manner in which the information or data was acquired; (2) the manner in which the appraisals were constructed; (3) the inventory on the date of the appraisal in detail; (4) the date of acquisition of all items remaining in the inventory as of the date of appraisal; (5) the elimination from the inventory of all items acquired subsequent to the date as of which the appraisal is made and how this was effected (all items, the date of acquisition of which can not be definitely determined, should be listed separately and all the facts bearing upon the date of acquisition given); (6) the replacement cost at the date as of which the appraisal is made of each item accepted as on hand on that date determined upon competent data, with a statement of the method employed in arriving at such cost (estimates and general statements will not be accepted); (7) the rate and total amount of depreciation as shown by the books; (8) the rate and total amount of depreciation taken upon each item included in the appraisal for the purposes of the appraisal (if other than normal rates of depreciation are used the reason therefor and the method of computing depreciation must be fully explained); (9) the actual cost when ascertainable of each item included in the appraisal; (10) the book value on the date as of which the appraisal is made of all the items included in the appraisal; and (11) a detailed statement of all plant facilities and additions, represented by capital expenditures previously written off, which were still in use on the date as of which the appraisal was made and all the depreciation actually sustained or accrued on such items. No claim will be allowed for paid-in surplus in any case in which the addition of value has been developed or ascertained subsequent to the date on which the property was paid in to the corporation, or in respect of property which the stockholders or their agents on or shortly before the date of such payment acquired at a bargain price, as, for instance, at a receiver's sale. Generally, allowable claims under this article will arise out of transactions in which there has been no substantial change of beneficial interest in the property paid in to the corporation, and in all cases the proof of value must be clear and explicit. (T. D. 3367; approved July 10, 1922, amending art. 836, Reg. 45.)

ART. 870. **Insurance companies.**—The reserve funds of life insurance companies, the net additions to which are deductible from gross income under the provisions of section 234 of the statute, can not be included in computing invested capital. The like reserve funds of insurance companies, other than life insurance companies, may be included in computing invested capital. See sections 325 and 326 (*a*) (3) and (*b*) and articles 569 and 814. (T. D. 3153; approved April 9, 1921, amending art. 870, Reg. 45.)

ART. 912. **Determination of first installment of tax in special cases.**—In the case of any corporation, other than a foreign corporation, where absolutely no data are available for the determination of invested capital for the taxable year, the installments of the tax shall in the first instance be determined upon the basis of a war-profits and excess-profits tax equal to 50 per cent of the net income, except that for 1919 and subsequent taxable years, in the case of any corporation other than a foreign corporation, such installments shall be determined upon the basis of an excess-profits tax equal to 20 per cent of the net income in excess of $3,000, but not in excess of $20,000, plus 40 per cent of the net income in excess of $20,000. In any other case under section 328 of the statute, other than the case of a foreign corporation, but including a case where the invested capital for the taxable year can not be accurately determined, but where a minimum amount of invested capital, as to which there is no question, can be determined, the installments shall in the first instance be determined upon the basis of a war-profits and excess-profits tax computed by using the minimum invested capital, the tax in any such case not to exceed an amount equal to 50 per cent of the net income, and for 1919 and subsequent taxable years not to exceed 20 per cent of the net income in excess of $3,000, but not in excess of $20,000, plus 40 per cent of the net income in excess of $20,000. (T. D. 3235; approved October 6, 1921, amending art. 912, Reg. 45.)

ART. 913. **Determination of first installment of tax in the case of foreign corporation.**—In the case of a foreign corporation the installments of the tax shall in the first instance be determined upon the basis of a war-profits and excess-profits tax computed by using its invested capital for the taxable year 1917, such tax for any taxable year not to exceed an amount equal to 50 per cent of the net income, and for 1919 and subsequent taxable years not to exceed 20 per cent of the net income not in excess of $20,000, plus 40 per cent of the net income in excess of $20,000. For the purpose of this article the invested capital for 1917 shall be adjusted for any subsequent changes in its amount due to cash or property paid in or withdrawn or to surplus or undivided profits of prior years retained in the business and properly attributable to its business within the United States. If the tax for 1917 was determined under section 210 of the Revenue Act of 1917, the constructive capital which would result in a tax equivalent to the tax determined under that section shall be used. In the case of a foreign corporation which was organized subsequent to the taxable year 1917, or which had no income from sources within the United States during 1917, the installments of the tax shall in the first instance be determined upon the basis of a war-profits and excess-profits tax equal to 50 per cent of the net income, except that for 1919 and subsequent taxable years such installments shall be determined upon the basis of an excess-profits tax equal to 20 per cent of the net income not in excess of $20,000, plus 40 per cent of the net income in excess of $20,000. (T. D. 3235; approved October 6, 1921, amending art. 913, Reg. 45.)

Art. 941. **Valuation of asset upon change of ownership.**—Where a business is reorganized, consolidated or transferred, or property is transferred, after March 3, 1917, and an interest or control of 50 per cent or greater in such business or property remains in the same persons or any of them, then for the purpose of determining invested capital each asset so transferred is valued (*a*) at an amount representing its actual cash value, subject to the limitations imposed by section 326, but not exceeding its allowable value, for invested capital purposes, in the possession of the previous owner, if a corporation, or, if not a corporation (*b*) at its cost to such previous owner, with proper adjustments for losses and improvements. This provision is accordingly concerned with the computation of invested capital for the taxable year, while section 330 of the statute is chiefly concerned with the determination of invested capital for the pre-war period. See articles 931, 932, and 1561–1570. (T. D. 3259; approved December 7, 1921, amending art. 941, Reg. 45.)

Art. 1001. **Time for payment of tax.**

Under the Revenue Act of 1918, approved February 24, 1919, the first installment of income and profits taxes becomes due and payable at the time fixed by law for filing the return, and the second installment becomes due and payable on the 15th day of the third month, the third installment on the 15th day of the sixth month, and the fourth installment on the 15th day of the ninth month, after the time fixed by law for filing the return. In the case of the first installment the law provides that the instructions printed on the return shall be deemed sufficient notice of the date when the tax is due and sufficient demand, and the taxpayer's computation of the tax on the return shall be deemed sufficient notice of the amount due. In the case of the second, third, and fourth installments a notice and demand for payment will be sent by the collector to each taxpayer by mail at least 10 days in advance of the date the tax is due, and this notice and demand will be notice and demand by the collector for the purpose of determining penalties and interest, as provided by law. The attention of taxpayers is called to the fact that the Revenue Act of 1918 omits the 10-day period of grace allowed by the former law. Failure to pay any installment on the due date will necessitate the addition of penalties and interest, as provided by law. (T. D. 3136; approved March 1, 1921, amending T. D. 2840 by adding above paragraph relating to art. 1001, Reg. 45.)

ART. 1009. **Collection of tax by distraint.**

The provisions of section 250 (*f*) of the Revenue Act of 1918 are applicable only to income, war-profits, and excess-profits taxes. Distraint warrants issued for the seizure of property to be sold to satisfy such taxes shall be deemed to have been served within the meaning of the statute when seizure is made of any of the property of the delinquent taxpayer subject to distraint by the officer charged with the execution of the warrant. (T. D. 3126; approved February 2, 1921, amending T. D. 3042, relating to art. 1009, Reg. 45.)

ART. 1013. **Declaration of termination of taxable period.**—In the case of a taxpayer who designs by immediate departure from the country or otherwise to avoid payment of the tax for the preceding or current taxable year, the commissioner may so find upon evidence satisfactory to him and may declare the taxable period for such taxpayer terminated at the end of the month last past, causing the service upon him of a notice and demand for immediate payment of the tax declared due and any other tax unpaid. In such a case the taxpayer is entitled to a full personal exemption and credit for dependents, if otherwise allowable. See section 216 of the statute and articles 301–7. Aliens departing from the United States will be required to present certificates of compliance with income tax obligations to internal revenue officers at the point of departure. Aliens, whether resident or nonresident, who intend to depart from this country should appear before the collector or deputy collector of internal revenue for the district in which they reside and satisfy all income tax obligations with respect to income received up to and including the calendar month next preceding that of their intended departure. Upon payment of such obligations or upon satisfactory evidence that no tax is due and payable the collector or deputy collector will issue a certificate of compliance to the applicant. A certificate of compliance issued by a collector or deputy collector must be presented at the office of the revenue agent at the point of departure, who will issue an income tax clearance which will be taken up at the pier. Aliens presenting themselves at the point of departure without such certificates of compliance will be examined by internal revenue officers at that point and such taxes as appear to be due and owing will be collected. American citizens departing from the United States will not be required to procure certificates of compliance or to present any other evidence of compliance with income tax obligations. If suit is necessary to collect the tax made due and payable by the provisions of section 250(*g*) of the statute, the commissioner's finding is presumptive evidence of the taxpayer's design. A taxpayer who is not in default in making returns or in paying other taxes may procure the postponement until the usual time of the payment of taxes declared or declarable to be due pursuant to this article by depositing with the commissioner United States bonds of a principal amount double the estimated amount of taxes due from such person for the taxable year or by furnishing such other security as may be approved by the commissioner. See section 1320. (T. D. 3229; approved September 12, 1921, amending art. 1013, Reg. 45, as amended by T. D. 3216.)

ART. 1032. **Claims for abatement of taxes erroneously assessed.**

The validity of an assessment depends upon the law and actual facts existing. Therefore, an assessment made upon an erroneous theory or by mistake may not be remitted or abated because so made, if, at the time its validity is passed upon, the commissioner is in possession of evidence which shows an equivalent amount of tax is properly due in connection with the income, transaction, or matter upon which the assessment is predicated. (T. D. 3251; approved November 25, 1921, relating to art. 1032, Reg. 45.)

ART. 1035. **Action on claims for credit.**—Upon receipt by the collector of a claim for credit on Form 47 A, he will take no action thereon until the following requirements have been met:

(*a*) The collector must ascertain from the commissioner whether a claim for refund for the year or years upon which the claim for credit is based, and upon substantially the same ground, has been filed. If no such claim for refund has been filed, the collector may, on notice thereof from the commissioner, accept for filing the taxpayer's claim for credit.

(*b*) When it is known to the collector that a refund claim of the nature referred to above is on file with the commissioner, and has not been adjusted, he will not accept the taxpayer's claim for credit for the same year or years until the taxpayer has requested the commissioner to reject such claim and has been advised by the commissioner that such claim has been rejected. Claims for refund may not be converted into claims for credit, except in the manner above mentioned.

Upon acceptance for filing of a claim for credit on Form 47 A, the collector shall certify thereon the required information concerning all outstanding assessments and payments covered thereby and shall note on his records that a claim for credit has been filed. He shall thereupon transmit the claim to the commissioner. Due notice will be given the collector and the taxpayer of the action taken on the claim. A schedule of credit claims on Form 7220 A will be transmitted to the collector once a month and formal credit shall be taken by the collector at that time. If a claim is allowed against additional taxes due for other years, but such other taxes have not yet been assessed, only the amount of the excess of such taxes over the overpayment shall be assessed, or the excess of the overpayment over such taxes due shall be refunded as the case may be. The effective date of the filing of a claim for credit shall be the actual date of presentation to the collector. The filing of a claim for credit against the tax due under another return shall be subject to the same rules with respect to the addition of interest and penalties as if the taxpayer had filed a claim for abatement of the tax against which credit is desired. See articles 1003 and 1006.

Under no circumstances will a taxpayer be permitted to take credit for an alleged refund due for a prior year on any return filed for a subsequent year without filing a formal claim for credit on Form 47 A, under the requirements as provided herein. An attempt to take a credit contrary to the instructions herein set forth shall not be held to be the filing of a claim under section 252 of the Revenue Act of 1918. (T. D. 3154; approved April 11, 1921, amending art. 1035, Reg. 45.)

For the more expeditious handling of refund, credit, and abatement claims, and to provide for the refund or credit of overpayments of revenues where no claims have been filed, the following procedure is established, to become effective December 16, 1921:

1. Reduction of internal-revenue assessments and adjustments of overpayments of revenues will hereafter be accomplished in one of three ways:

(*a*) On the basis of an application submitted by a taxpayer on Form 46, 47, or 47 A, together with appropriate supporting evidence to be filed in the office of the collector of internal revenue of the district in which the tax is assessed.

(*b*) On the basis of a certificate of overassessment prepared by the appropriate administrative unit in the bureau in each case in which an overassessment of tax is disclosed through the audit of a return.

(*c*) On the basis of a blanket claim (Form 751); a schedule of taxes found to be uncollectible (Form 53); or a schedule of duplicate payments and overpayments due to obvious error on all forms of taxable returns (blanket Form 47 or 47B) submitted by a collector of internal revenue. Form 751 will be used only in cases where credit balances exist, regardless of the class of return filed.

2. Claims of taxpayers and the items of collectors' blanket claims (if and when found by an administrative unit to be allowable), and certificates of overassessment (upon final approval), and items credited in account 9 (*e*) shall be scheduled on Form 7777 and submitted to the Commissioner of Internal Revenue for approval. Upon approval by the commissioner, such schedules shall be forwarded to the collectors of internal revenue of the several districts.

3. Upon receipt of such schedules the several collectors of internal revenue shall immediately check the items thereon against the accounts of the several taxpayers concerned and determine whether the several amounts of overassessments should be abated, refunded, or credited against assessments remaining unpaid. Only overpayments of income and profits taxes may be credited against unpaid assessments of such taxes (sec. 252, Revenue Act 1921). Whenever, on such examination of a taxpayer's account and of the items in account 9 (*e*), a collector finds an amount of overpayment, he shall examine all accounts of the taxpayer for subsequent periods and determine and certify the amount, if any, of such overpayment that shall be credited against the taxpayer's account for any subsequent year or years and the amount of such overpayment for which a disbursement check should be issued. He shall thereupon make appropriate entries upon all copies of the schedules and upon the assessment list, indicating the application made by him of the several amounts of overassessment and overpayment (whether by abatement or by credit), and the amounts to be refunded; summarize the amounts applied in abatement, the amounts of overpayment and of credit; certify all copies of the schedule; retain one copy, and forward the others to the Commissioner of Internal Revenue at Washington.

4. The collector shall, at the same time, prepare (in quadruplicate) on Form 7777 A a schedule of net refundable amounts for which disbursement checks are to be issued; retain one copy of the schedule for his record; certify the other three copies and forward them, together with the copies of the schedules on Form 7777, to the Commissioner of Internal Revenue at Washington.

5. Upon application of the several amounts of overassessment and overpayment as abatements or credits, and the determination of the amounts to be refunded, the collector of internal revenue shall make the appropriate entries upon the certificates of overassessment which will be forwarded to him with the schedules; and transmit appropriate copies of such certificates to the several taxpayers as notification of the action taken by the collector in the way of abatement or credit; provided, however, that in those cases in which any amount of overpayment is to be refunded, the collector shall not send the certificate of overassessment to the taxpayer, but shall make the appropriate entries thereon and forward such certificates of overassess-

ment with the schedule of refundable amounts to the Commissioner of Internal Revenue at Washington.

6. Upon completion and certification of a schedule the collector of internal revenue shall credit the accounts with the amounts abated and credited and make proper notations of the refunds. The proper account 6 will be credited, and account 18 will be debited with the total amount abated and applied as credits for the reduction of tax liability. Account 9 (*e*) will be debited with the total amount applied as credits from items in account 9 (*e*). The procedure as outlined in section 583 of the Internal Revenue Manual, in cases of this nature, should be carefully followed.

7. Upon receipt of properly certified copies of Form 7777 and 7777 A, the commissioner shall cause to be made the necessary entries in the control accounts of the Bureau of Internal Revenue and the necessary allowance documents prepared. Upon receipt of these schedules the accounts unit of the Bureau of Internal Revenue shall retain one copy of Form 7777 for its records and forward a copy to the General Accounting Office of the Comptroller General as a voucher for the collection accounts of the collector. He shall retain one copy of the schedule of refunds (Form 7777 A) for his records, make the necessary entries upon, and forward two copies with the allowance documents to the commissioner for his approval.

8. Upon approval of schedules of refunds (Form 7777 A) the commissioner will forward such schedules with the allowance documents to the disbursing clerk of the Treasury Department.

9. Upon receipt of properly approved schedules and allowance documents, the disbursing clerk shall prepare disbursement checks in the amounts of the several net refundable items in favor of the respective taxpayers against whose accounts net refundable amounts shall have been allowed by the commissioner; forward such checks, together with the certificates of overassessment (which will be transmitted to him) to the respective taxpayers; retain one copy of this schedule for his record; and transmit the other copy to the General Accounting Office of the Comptroller General as a voucher for his disbursement account. (T. D. 3260; approved December 8, 1921, relating to arts. 1035 and 1036, Reg. 45.)

ART. 1036. **Claims for refund of taxes erroneously collected.**—See article 1035 above.

ART. 1073. **Return of information by partnerships, personal service corporations, and fiduciaries.**—Partnerships and personal service corporations shall prepare reports on Form 1099 for each member of the partnership or personal service corporation, and fiduciaries shall prepare such reports for each beneficiary of the estate or trust, showing in every case the distributive shares of the members or beneficiaries, whether or not actually distributed. If the books of account of a partnership, personal service corporation, or fiduciary are kept on the basis of a fiscal year, the returns of information, Form 1099, showing the distributive shares of the members or beneficiaries, shall be rendered on a fiscal year basis. Such returns, accompanied by Form 1096, shall be filed on or before the fifteenth day of the third month following the close of the fiscal year. All other returns of information, Form 1099, required to be filed by a partnership, personal service corporation, or a fiduciary, shall be rendered on a calendar year basis, regardless of the fact that its books of account are kept on a fiscal year basis. Such returns, accompanied by Form 1096 shall be filed on or before March 15 of the year following that for which the returns are made. (T. D. 3210; approved August 4, 1921, amending art. 1073, Reg. 45.)

ART. 1091. **Inspection of returns.**

Section 2 of the Tariff Act of October 3, 1913, imposes an income tax on individuals, corporations, joint-stock companies or associations, and insurance companies, and paragraph G (*d*) of said section provides:

When the assessment shall be made, as provided in this section, the returns, together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the Commissioner of Internal Revenue and shall constitute public records and be open to inspection as such: *Provided*, That any and all such returns shall be open to inspection only upon the order of the President, under rules and regulations to be prescribed by the Secretary of the Treasury and approved by the President: * * *.

Title I of the Revenue Act of 1916 imposes an income tax on individuals, estates, trusts, corporations, joint-stock companies, associations, and insurance companies, and section 14 (*b*) of said title provides:

When the assessment shall be made, as provided in this title, the returns, together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the Commissioner of Internal Revenue and shall constitute public records and be open to inspection as such: *Provided*, That any and all such returns shall be open to inspection only upon order of the President, under rules and regulations to be prescribed by the Secretary of the Treasury and approved by the President: * * *.

Title II of the Revenue Act of 1917 imposes a war excess-profits tax on individuals, partnerships, corporations, joint-stock companies, associations, and insurance companies, and section 212 of said title provides:

That all administrative, special, and general provisions of law, including the laws in relation to the assessment, remission, collection, and refund of internal-revenue taxes not heretofore specifically repealed and not inconsistent with the provisions of this title are hereby extended and made applicable to all the provisions of this title and to the tax herein imposed, and all provisions of Title I of such Act of September eighth, nineteen hundred and sixteen, as amended by this act, relating to returns and payment of the tax therein imposed, including penalties, are hereby made applicable to the tax imposed by this title.

Title II of the Revenue Act of 1918 and Title II of the Revenue Act of 1921 imposes an income tax on individuals, estates, trusts, corporations, associations, joint-stock companies, and insurance companies, and section 257 of each of said titles provides:

That returns upon which the tax has been determined by the commissioner shall constitute public records; but they shall be open to inspection only upon order of the President and under rules and regulations prescribed by the Secretary and approved by the President: * * *.

Title III of the Revenue Act of 1918 and Title III of the Revenue Act of 1921 imposes a war-profits and excess-profits tax on corporations, associations, joint-stock companies, and insurance companies, in addition to other taxes imposed by such Acts, and section 336 of each of said titles provides:

That every corporation, not exempt under section 304, shall make a return for the purposes of this title. Such returns shall be made, and the taxes imposed by this title shall be paid, at the same times and places, in the same manner, and subject to the same conditions, as is provided in the case of returns and payment of income tax by corporations for the purposes of Title II, and all the provisions of that title not inapplicable, including penalties, are hereby made applicable to the taxes imposed by this title.

Section 1000, Title X, of the Revenue Act of 1918 imposes on corporations, associations, joint-stock companies, and insurance companies a special excise tax with respect to carrying on or doing business, and subdivision (*d*) of said section provides:

Section 257 shall apply to all returns filed with the Commissioner for purposes of the tax imposed by this section.

Section 1000, Title X, of the Revenue Act of 1921 imposes on corporations, associations, and joint-stock companies a special excise tax with respect to carrying on or doing business, and subdivision (*c*) of the said section provides:

Section 257 shall apply to all returns filed with the Commissioner for purposes of the tax imposed by this section.

Pursuant to these provisions of law the President orders that returns of individuals, partnerships, estates, trusts, corporations, associations, joint-stock companies, and insurance companies filed under the provisions of section 2 of the Tariff Act of October 3, 1913, Title I of the Revenue Act of 1916, Title II of the Revenue Act of 1917, Titles II and III and section 1000, Title X, of the Revenue Act of 1918, and Titles II and III and section 1000, Title X, of the Revenue Act of 1921 shall be open to inspection in accordance and upon compliance with the following rules and regulations:

1. These regulations deal only with *inspection* of returns, as the statutes expressly require the approval of the President of regulations on this subject. Other uses to which returns may be lawfully put, without action by the President, are not covered by these regulations.

2. The word "corporation" when used alone herein shall, unless otherwise indicated, include corporations, associations, joint-stock companies, and insurance companies. The word "return" when so used shall, unless otherwise indicated, include income and profits tax returns; and also special excise tax returns of corporations filed pursuant to section 1000, Title X, of each of the Revenue Acts of 1918 and 1921.

3. Written statements filed with the Commissioner of Internal Revenue designed to be supplemental to and to become a part of tax returns shall be subject to the same rules and regulations as to inspection as are the tax returns themselves.

4. Except as hereinafter specifically provided, the Commissioner of Internal Revenue may, in his discretion, upon written application setting forth fully the reasons for the request, grant permission for the inspection of returns in accordance with these regulations. The application will be considered by the Commissioner and a decision reached by him whether the applicant has met the conditions imposed by these regulations and whether the reasons advanced for permission to inspect are sufficient to permit the inspection. Such written application is not required of the officers and employees of the Treasury Department whose official duties require inspection of a return, or of the Solicitor of Internal Revenue.

5. The return of an individual shall be open to inspection as follows:

(*a*) By the officers and employees of the Treasury Department whose official duties require such inspection and by the Solicitor of Internal Revenue; (*b*) by the person who made the return, or by his duly constituted attorney in fact; (*c*) by the administrator, executor, or trustee of the taxpayer's estate, or by the duly constituted attorney in fact of such administrator, executor, or trustee, where the maker of the return has died; and (*d*) in the discretion of the Commissioner of Internal Revenue, by one of the heirs at law or next of kin of such deceased person upon showing that he has a material interest which will be affected by information contained in the return.

6. A joint return of a husband and wife shall be open to inspection (*a*) by the officers and employees of the Treasury Department whose official duties require such inspection and by the Solicitor of Internal Revenue; and (*b*) by either spouse for whom the return was made (or his or her duly constituted attorney in fact; or legal

representative) upon satisfactory evidence of such relationship being furnished.

7. The return of a partnership shall be open to inspection (*a*) by the officers and employees of the Treasury Department whose official duties require such inspection and by the Solicitor of Internal Revenue and (*b*) by any individual (or his duly constituted attorney in fact or legal representative) who was a member of such partnership during any part of the time covered by the return, upon satisfactory evidence of such fact being furnished.

8. The return of an estate shall be open to inspection (*a*) by the officers and employees of the Treasury Department whose official duties require such inspection and by the Solicitor of Internal Revenue; (*b*) by the administrator, executor, or trustee of such estate, or by his duly constituted attorney in fact; and (*c*) by one of the heirs at law or next of kin of the deceased person whose estate is being administered upon a showing of a material interest which will be affected by information contained in the return.

9. The return of a trust upon which a tax has been determined shall be open to inspection (*a*) by the officers and employees of the Treasury Department whose official duties require such inspection and by the Solicitor of Internal Revenue; (*b*) by the trustee or trustees, or the duly constituted attorney in fact of such trustee or trustees; and (*c*) by any individual (or his duly constituted attorney in fact or legal representative) who was a beneficiary under such trust during any part of the time covered by the return, upon satisfactory evidence of such fact being furnished.

10. The return of a corporation shall be open to inspection (*a*) by the officers and employees of the Treasury Department whose official duties require such inspection and by the Solicitor of Internal Revenue; (*b*) upon satisfactory evidence of identity and official position by the president, vice president, secretary, or treasurer of such corporation, or, if none, its principal officer; and (*c*) by a stockholder of such corporation as provided in paragraph 11 hereof.

11. A stockholder of record owning 1 per cent or more of the shares of the outstanding stock of a corporation may be permitted to inspect its return. Such permission will only be granted upon an application in writing to the Commissioner of Internal Revenue, accompanied by an affidavit showing applicant's address, the name of the corporation, the period of time covered by the return he desires to inspect, and a certificate from the officials of the corporation or other satisfactory evidence showing the amount of the corporation's outstanding capital stock, the number of shares owned by the applicant, the date when such stock was acquired, and satisfactory proof of identity. This privilege of inspection is personal and will be granted only to the stockholders. This rule has no

application to the return of a corporation filed pursuant to the Revenue Acts of 1918 and 1921; specific provision ,independent of presidential regulation, being made in those acts for inspection by a stockholder of a return of a corporation filed thereunder (second proviso of section 257).

12. When the head of an executive department (other than the Treasury Department) or of any other United States Government establishment, desires to inspect or to have some other officer or employee of his branch of the service inspect a return in connection with some matter officially before him, the inspection may, in the discretion of the Secretary of the Treasury, be permitted upon written application to him by the head of such executive department or other Government establishment. The application must be signed by such head and must show in detail why the inspection is desired, the name and address of the taxpayer who made the return, and the name and official designation of the one it is desired shall inspect the return. When the head of a bureau or office in the Treasury Department, not a part of the Internal Revenue Bureau, desires to inspect a return in connection with some matter officially before him, other than an income, profits tax, or corporation excise tax matter, the inspection may, in the discretion of the Secretary, be permitted upon written application to him by the head of such bureau or office, showing in detail why the inspection is desired. The reasons submitted for permission to inspect as provided in this paragraph shall be considered by the Secretary and a decision reached by him whether the reasons are sufficient to permit the inspection.

13. When it becomes necessary for the department to furnish returns or copies thereof for use in legal proceedings, inspection of such returns or copies that necessarily results from such use is permitted.

14. Except as provided in paragraph 13 returns may be inspected only in the office of the Commissioner of Internal Revenue, Washington, D. C.

15. A person who, under these regulations, is permitted to inspect a return may make and take a copy thereof or a memorandum of data contained therein.

16. By section 3167, Revised Statutes, as amended by the Revenue Act of 1918, and reenacted without change in section 1311 of the Revenue Act of 1921, it is made a misdemeanor for any person to print or publish in any manner whatever not provided by law any income return, or any part thereof or source of income, profits, losses, or expenditures, appearing in any income return, which misdemeanor is punishable by a fine not exceeding $1,000 or by imprisonment not exceeding one year, or both, at the discretion of the court, and if the

offender be an officer or employee of the United States, by dismissal from office or discharge from employment.

17. All former regulations bearing on the subject of inspection of returns are hereby superseded.

18. These regulations shall remain in force until expressly withdrawn or overruled. (T. D. 3277; approved January 24, 1922, relating to arts. 1091, 1092, and 1093, Reg. 45.)

ART. 1091(*a*). **Furnishing of copies of income returns.**—1. The original income return of an individual, partnership, corporation, association, joint-stock company, insurance company or fiduciary, or a copy thereof, may be furnished by the Commissioner of Internal Revenue to a United States attorney for use as evidence before a United States grand jury or in litigation in any court, where the United States is interested in the result, or for use in the preparation for such litigation, or to an attorney connected with the Department of Justice designated to handle such matters, upon written request of the Attorney General, the Assistant to the Attorney General, or an Assistant Attorney General. When an income return or copy thereof is thus furnished, it must be limited in use to the purpose for which it is furnished and is under no conditions to be made public except where publicity necessarily results from such use. In case the original return is necessary, it shall be placed in evidence by the Commissioner of Internal Revenue or by some other officer or employee of the Internal Revenue Bureau designated by the commissioner for that purpose, and after it has been placed in evidence it shall be returned to the files in the office of the commissioner in Washington. An original return will be furnished only in exceptional cases, and then only when it is made to appear that the ends of justice may otherwise be defeated. Neither the original nor a copy of an income return, desired for use in litigation in court where the United States Government is not interested in the result and where such use might result in making public the information contained therein, will be furnished, except as otherwise provided in the next succeeding paragraph. (T. D. 3188; approved June 30, 1921, amending par. 1, art. 1091(a), Reg. 45. For convenient reference, the unamended part of this article is printed below.)

2. A copy of an income return may be furnished by the Commissioner of Internal Revenue to the person who made the return or to his duly constituted attorney, or if the person is deceased, to his executor or administrator; or if the entity is in the hands of a receiver, trustee in bankruptcy, guardian, or similar legal custodian, to the receiver, trustee, or other similar custodian upon written application for same, accompanied by satisfactory evidence that the applicant comes within this provision. "The person who made

the return," as herein used, refers in the case of an individual return to the individual whose return is desired, and in the case of a return of a corporation, association, joint-stock company, insurance company, or fiduciary to the corporation, association, joint-stock company, or fiduciary, a copy of whose return is desired. A corporation may also designate by proper action of its board of directors the officer or individual to whom a copy of a return made by the corporation may be furnished, and upon sufficient evidence of such action and of the identity of the officer or individual, a copy may be furnished to such person. A copy of a partnership income return will be furnished to the partners only in case all the partners join in the request therefor, it matters not what particular partner or officer of the partnership made the return. If the partnership has been dissolved, the members surviving may be furnished a copy if all the members surviving join in the request.

ART. 1092. **Inspection of returns by State.**—See article 1091.

ART. 1093. **Inspection of returns by stockholder.**—See article 1091.

ART. 1509. **Domestic and foreign persons.**—A domestic corporation or partnership is one organized or created in the United States, including only the States, the Territories of Alaska and Hawaii, and the District of Columbia, and a foreign corporation or partnership is one organized or created outside the United States as so defined. A domestic corporation is a resident corporation even though it does no business and owns no property in the United States. The nationality or residence of members of a partnership does not affect its status. A partnership created by articles entered into in San Francisco between residents of the United States and residents of China is a domestic partnership. A foreign corporation engaged in trade or business within the United States or having an office or place of business therein is sometimes referred to in the regulations as a resident foreign corporation, and a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein as a nonresident foreign corporation. See also articles 4 and 312–315. (T. D. 3287; approved February 18, 1922, amending art. 1509, Reg. 45.)

ART. 1543. **Distributions which are not dividends.**—A distribution by a corporation out of earnings or profits accumulated prior to March, 1, 1913, or out of any assets except earnings or profits accumulated since February 28, 1913, is not a dividend within the meaning of the statute. A distribution by a personal service corporation out of earnings or profits accumulated since December 31, 1917, is not a dividend. A distribution out of earnings or profits accumulated before March 1, 1913, is free from tax as a dividend; out of assets other than earnings or profits accumulated since February 28, 1913, may or may not be free from tax, according as each stockholder receives more or less than he paid for his stock. However, if such stock was acquired prior to March 1, 1913, and the fair market value as of such date was greater than the cost thereof and less than the sum received in distribution, the amount which is taxable is the excess over such market value as of March 1, 1913, of the sum received in the distribution, but no gain is recognized if the amount received in distribution is more than the cost but less than the fair market value of the stock on March 1, 1913. In the case of a personal service corporation a distribution out of earnings or profits accumulated since December 31, 1917, is taxed to the stockholders as though they were partners. See section 218 of the statute and articles 328–335. In determining whether a distribution is made out of earnings or profits accumulated after or before March 1, 1913, due consideration must be given to the facts and mere book entries increasing or decreasing the surplus will not be conclusive. (T. D. 3206; approved July 28, 1921, amending art. 1543, Reg. 45.)

ART. 1547. **Sale of stock received as dividends.**—Stock issued by a corporation as a dividend does not constitute taxable income to a stockholder in such corporation, but gain may be derived or loss sustained by the stockholder from the sale of such stock. The amount of taxable gain derived or deductible loss sustained from the sale of such stock, or from the sale of the stock with respect to which it is issued, shall be determined as provided in article 1561 as amended, after the cost, or both the cost and fair market value as of March 1, 1913, if acquired prior thereto, of both the old and the new shares is determined in accordance with the following rules:

(1) Where the stock issued as a dividend is all of substantially the same character or preference as the stock upon which the stock dividend is paid, the cost of each share, and when acquired prior to March 1, 1913, the fair market value as of such date, will be the quotient of the cost, or such fair market value of the old shares of stock, divided by the total number of the old and new shares.

(2) Where the stock issued as a dividend is in whole or in part of a character or preference materially different from the stock upon which the stock dividend is paid, the cost, and when acquired prior to March 1, 1913, the fair market value as of such date, of the old shares of stock shall be divided between such old stock and the new stock, in proportion as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are issued, and the cost, and when acquired prior to March 1, 1913, the fair market value as of such date, of each share of stock will be the quotient of the cost or such fair market value as of March 1, 1913, of the class to which such share belongs divided by the number of shares in that class.

(3) Where the stock with respect to which a stock dividend is issued was purchased at different times and at different prices and the identity of the lots can not be determined, any sale of the original stock will be charged to the earliest purchases of such stock (see article 39 as amended), and any sale of dividend stock issued with respect to such stock will be presumed to have been made from the stock issued with respect to the earliest purchased stock, to the amount of the dividend chargeable to such stock. (T. D. 3206; approved July 28, 1921, amending art. 1547, Reg. 45.)

(4) Where the stock with respect to which a stock dividend is declared was purchased at different times and at different prices, and the identity of the lots can or can not be determined, but the dividend stock isued with respect to such stock can not be identified as having been issued with respect to any particular lot of such stock, then any sale of such dividend stock will be presumed to have been made from the stock issued with respect to the earliest purchased stock, the amount of the stock dividend chargeable to such stock. (T. D. 3238; approved October 22, 1921, adding par. (4) to art. 1547, Reg. 45.)

Art. 1548. **Distribution in liquidation.**—So-called liquidation or dissolution dividends are not dividends within the meaning of the statute, and amounts so distributed, whether or not including any surplus earned since February 28, 1913, are to be regarded as payment for the stock of the dissolved corporation. Any excess so received over the cost of his stock to the stockholder constitutes income to such stockholder. However, if such stock was acquired prior to March 1, 1913, and the fair market value as of such date was greater than the cost but less than the amount so distributed, the taxable income is the excess over such fair market value of the amount received, but no gain is recognized if the amount received, although more than cost, is less than the fair market value of the stock on March 1, 1913. A distribution in liquidation of the assets and business of a corporation, which is a return to the stockholder of the value of his stock upon a surrender of his interest in the corporation, is distinguishable from a dividend paid by a going corporation out of current earnings or accumulated surplus when declared by the directors in their discretion, which is in the nature of a recurrent return upon the stock. (T. D. 3206; approved July 28, 1921, amending art. 1548, Reg. 45.)

Art. 1549. **Distribution from depletion or depreciation reserve.**—A reserve set up out of gross income by a corporation and maintained for the purpose of making good any loss of capital assets on account of depletion or depreciation is not a part of its surplus out of which ordinary dividends may be paid. A distribution made from such a reserve will be considered a liquidating dividend and will constitute income to a stockholder to the extent that the amount so received is in excess of the cost of his shares of stock. If such stock were acquired prior to March 1, 1913, and the fair market value as of such date was greater than the cost thereof and less than the amount received, the income which is taxable is the excess over such market value of the amount received, but no gain is recognized if the amount received is more than the cost but less than the fair market value of the stock on March 1, 1913. No distribution, however, will be deemed to have been made from such a reserve except to the extent that the amount paid exceeds the surplus and undivided profits of the corporation. In general, any distribution made by the corporation other than out of earnings or profits accumulated since February 28, 1913, is to be regarded as a return to the stockholder of part of the capital represented by his shares of stock, and upon a subsequent sale of such stock his gain will be the excess of the selling price over the cost of the stock after applying on such cost the amount of such capital distribution. However, if such shares were acquired prior to March 1, 1913, and the fair market value as of such date was greater than the cost thereof after applying on such cost and value the amount of any such capital distribution, and was less than the sum received in distribution, the amount which is taxable is the excess over such value of the sum received in distribution. But no gain is recognized if the amount received is more than the cost but less than the fair market value of the stock on March 1, 1913, after the amount of any such capital distribution is applied to such cost and value. (T. D. 3206; approved July 28, 1921, amending art. 1549, Reg. 45.)

ART. 1561. **Basis for determining gain or loss from sale.**—For the purpose of ascertaining the gain or loss from the sale or exchange of property the basis is the cost of such property, or if acquired on or after March 1, 1913, its cost or its approved inventory value. But in the case of property acquired before March 1, 1913, when its fair market value as of that date is in excess of its cost, the gain which is taxable is the excess of the amount realized therefor over such fair market value. Also in the case of property acquired before March 1, 1913, when its fair market value as of that date is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor. No gain or loss is recognized in the case of property sold or exchanged (*a*) at more than cost but at less than its fair market value as of March 1, 1913, or (*b*) at less than cost but at more than its fair market value as of March 1, 1913. In any case proper adjustment must be made for any depreciation or depletion sustained. What the fair market value of property was on March 1, 1913, is a question of fact to be established by any evidence which will reasonably and adequately make it appear. As to inventories see section 203 of the statute and articles 1581–1588. The fair market value as of March 1, 1913, has no bearing on the determination of the invested capital of a corporation for the purpose of the war-profits and excess-profits tax. See section 326 and article 831. (T. D. 3206; approved July 28, 1921, amending art. 1561, Reg. 45.)

The following opinion rendered by the Attorney General under date of August 23, 1922, respecting the basis to be used for determining taxable gain or deductible loss in the case of property acquired prior to March 1, 1913, and sold or disposed of subsequent thereto is published in full for your information and guidance.

DEPARTMENT OF JUSTICE,
Washington, August 23, 1922.

SIR: I have the honor to acknowledge receipt of your letter of June 26, 1922, in which you request my opinion as to the proper basis to be used, under the Revenue Acts of 1916, 1917, and 1918, in computing the taxable gain or deductible loss in the case where property, acquired prior to March 1, 1913, is sold or disposed of thereafter. Accompanying your letter was a brief submitted by the M company, in which the validity of the regulations of the internal revenue and the procedure thereunder are questioned by the company specifically as to the following cases:

Where property acquired prior to March 1, 1913, is sold subsequent thereto at a price which is—

(*a*) Greater than the value thereof on March 1, 1913, which was higher than cost, or

(*b*) Greater than the cost thereof, which was higher than the value on March 1, 1913, or

(*c*) Greater than the value thereof on March 1, 1913, but less than cost, or

(*d*) Less than the value thereof on March 1, 1913, which was less than cost, or

(*e*) Less than the value thereof on March 1, 1913, but greater than cost, or

(*f*) Less than the cost thereof, which was less than the value on March 1, 1913.

The provisions of the Revenue Act of 1916 material to the subject under consideration, and not changed in any way by the Act of 1917, are:

SEC. 2. (*a*) That, subject to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from * * * businesses, trade, commerce, or sales, or dealings in property whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever;

* * * * * * *

(*c*) For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived.

SEC. 5. * * *

(*a*) For the purpose of the tax there shall be allowed as deductions—

Fourth. Losses actually sustained during the year, incurred in his business or trade. * * *; *Provided*, That for the purpose of ascertaining the loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such loss sustained;

Fifth. In transactions entered into for profit but not connected with his business or trade, the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom;

* * * * * * *

Sec. 10. * * * For the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition by a corporation, joint-stock company or association, or insurance company, of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived or loss sustained.

The Act of 1918, dealing with the questions propounded, are:

Sec. 202. (*a*) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203.

Sec. 213. That for the purpose of this title * * * the term "gross income"—

(*a*) Includes gains, profits, and income derived from * * * trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever * * *.

T. D. 3206 reads in part as follows:

Regulations No. 45 (1920 edition) are hereby amended in order that the rule announced by the Supreme Court in the cases of Goodrich *v.* Edwards and Brewster *v.* Walsh, respecting the basis for the determination of taxable gain or deductible loss in the case of property acquired prior to March 1, 1913, and sold or disposed of subsequent thereto, may be incorporated therein. * * *

Art. 1561. *Basis for determining gain or loss from sale.*—For the purpose of ascertaining the gain or loss from the sale or exchange of property the basis is the cost of such property, or if acquired on or after March 1, 1913, its cost or its approved inventory value. But in the case of property acquired before March 1, 1913, when its fair market value as of that date is in excess of its cost, the gain which is taxable is the excess of the amount realized therefor over such fair market value. Also in the case of property acquired before March 1, 1913, when its fair market value as of that date is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor. No gain or loss is recognized in the case of property sold or exchanged (*a*) at more than cost but at less than its fair market value as of March 1, 1913, or (*b*) at less than cost but at more than its fair market value as of March 1, 1913 * * *.

In the case of Goodrich *v.* Edwards (255 U. S. 527) the question of what constituted gain within the meaning of the Revenue Act of 1916 was passed upon by the United States Supreme Court, which adopted a concession made by the Solicitor General to the effect that where no gain was realized by the taxpayer on a complete transaction, notwithstanding that the selling price was higher than the value on March 1, 1913, no tax should have been assessed against him; holding that section 2 (*c*) was applicable only where a gain over the original capital investment had been realized after March 1, 1913, from a sale or other disposition of property, establishing the rule that increases in value occurring prior to March 1, 1913, should be excluded in computing taxable gain, and that only increases occurring subsequent to such date should be taxed.

Taxable gain having been thus construed by the Supreme Court, it follows that "deductible loss" should have the same construction, the provisions relating to losses being practically identical with those relating to gain. In making the concession as to taxable gains, the Solicitor General, in his brief in the Goodrich cases cited above made the further concession that a loss on the complete transaction must have been sustained in order to make it a deductible loss, and that only the loss occurring subsequent to March 1, 1913, should be allowed as a deduction.

The provisions of the Revenue Act of 1913 which deal with the subject of taxable gains and deductible losses are:

SEC. 202. (*a*) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203.

SEC. 213. That for the purpose of this title * * * the term "gross income"

(*a*) Includes gains, profits, and income derived from * * * trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

No substantial changes having been made in the corresponding sections of the two acts, it is assumed that both acts were intended by Congress to have the same construction, and the same basis should be employed in arriving at taxable gains and deductible losses upon the sale or other disposition of property.

I am of the opinion that the date March 1, 1913, was intended to be used as a guide in ascertaining gains derived or losses sustained, but that the original cost should be taken into consideration, so that if there was no gain on the entire transaction there was no taxable gain, and if there was no loss on the entire transaction there was no deductible loss. It follows, therefore, that in limiting the M company to the loss sustained by it on the sale of shares of stock of the O company; that is, the difference between cost and selling price, instead of to the difference between March 1, 1913, value and selling price, the Internal Revenue Bureau acted in accordance with law. In other words, the basis to be employed, under the Acts of 1916, 1917, and 1918, for the purpose of ascertaining the gain or loss from the sale or other disposition of property is the cost; and that in the case of property acquired prior to March 1, 1913, when its fair market value as of that date is in excess of its cost, the taxable gain is the excess of the amount realized over such fair market value; that when its fair market value as of March 1, 1913, is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor; and that when the property is sold or otherwise disposed of at more than cost but at less than March 1, 1913, value, or at less than cost but at more than March 1, 1913, value, neither taxable gain nor deductible loss results.

Replying specifically to the inquiry, I am of the opinion that where property acquired prior to March 1, 1913, is sold or disposed of thereafter—

(*a*) Taxable gain resulted if the selling price was higher than the value on March 1, 1913, and if that value was higher than the cost thereof, to the extent that the selling price exceeded the value on March 1, 1913;

(*b*) Taxable gain resulted if the selling price was greater than the cost and if the cost was greater than the value on March 1, 1913, to the extent that the selling price exceeded the cost of the property sold or disposed of;

(*c*) No taxable gain or allowable loss resulted if the selling price was greater than the value of the property on March 1, 1913, but less than the cost thereof;

(*d*) An allowable loss resulted if the selling price was less than the value on March 1, 1913, and if that value was less than the cost to the extent of the difference between the value on March 1, 1913, and the selling price;

(*e*) No taxable gain or deductible loss resulted if the selling price was less than the value thereof on March 1, 1913, but greater than the cost; or

(*f*) An allowable loss resulted if the selling price was less than the cost and if the cost was less than the value on March 1, 1913, to the extent that the cost of the property disposed of exceeded the selling price thereof.

Respectfully,

H. M. DAUGHERTY, *Attorney General.*

The honorable the SECRETARY OF THE TREASURY.

(T. D. 3393; approved September 12, 1922, relating to art. 1561, Reg. 45.)

ART. 1562. **Sale of property acquired by gift or bequest.**—The cost of such property to the person making the sale or other disposition thereof is the fair market value of the property at the date of acquisition and the taxable gain derived or the deductible loss sustained from such sale or other disposition shall be computed in accordance with the provisions of article 1561 as amended. For the purpose of determining the profit or loss from sale of property acquired by bequest, devise, or descent since February 28, 1913, its value as appraised for the purpose of the Federal estate tax, or in the case of estates not subject to that tax, its value as appraised in the State court for the purpose of State inheritance taxes, should be deemed to be its fair market value when acquired. See section 213 (*b*) (3) of the statute and article 73. (T. D. 3206; approved July 28, 1921, amending art. 1562, Reg. 45.)

ART. 1564. **Determination of gain or loss from exchange of property.**—(*a*) The amount of income derived from an exchange of property, as of stock for a bond, is the excess of the fair market value at the time of exchange of the property received in exchange over the original cost of the property exchanged for it. If the property exchanged was acquired prior to March 1, 1913, and its fair market value on that date was greater than the cost, the income which is taxable is the excess of the fair market value at the time of exchange of the property received in exchange over the fair market value on March 1, 1913, of the property exchanged. No gain is recognized if the fair market value of the property received in exchange is more than the cost of the property exchanged but less than its fair market value as of March 1, 1913. The amount of income derived from a subsequent sale for cash of property received in exchange for other property on or after March 1, 1913, is the excess of the amount so received over the fair market value of the property acquired at the date of the acquisition. (*b*) If the property received in exchange is substantially the same property or has no market value, then no gain or loss is realized, but the new property is to be regarded as substituted for the old, and upon the sale of the new property the amount of income derived is the excess of the amount so received over the cost of the old. However, if the old was acquired prior to March 1, 1913, and its fair market value as of that date is in excess of its cost but less than the amount received, the taxable gain is the excess over such value as of March 1, 1913, of the amount received. No gain is recognized if the property is sold at more than the cost of the old property but at less than its fair market value as of March 1, 1913. (T. D. 3206; approved July 28, 1921, amending art. 1564, Reg. 45.)

ART. 1565. **Exchange for different kinds of property.**—(*a*) If property is exchanged for two different kinds of property, such as bonds and stock, the bonds having a market value and the stock none, the value of the bonds is to be compared with the cost. If the market value of the bonds is less than such cost the difference represents the cost of the stock. If the market value of the bonds is greater than such cost the difference represents gain and is taxable at the time of the exchange unless the original property was acquired prior to March 1, 1913, in which case the amount of gain taxable is computed as provided in article 1564 as amended. In either case the entire proceeds of such stock will be taxable. (*b*) If property is exchanged for two different kinds of property, such as bonds and stocks, neither having a fair market value, the cost of the original property should be apportioned, if possible, between the bonds and stock for the purpose of determining gain or loss on subsequent sales. If no fair apportionment is practicable, no profit on any subsequent sale of any part of the bonds or stock is realized until out of the proceeds of sales shall have been recovered the entire cost of the original property. (T. D. 3206; approved July 28, 1921, amending art. 1565, Reg. 45.)

ART. 1566. **Exchange of property and stock.**—Where property is transferred to a corporation in exchange for its stock, the exchange constitutes a closed transaction, and the former owner of the property realizes a gain or loss if the stock has a market value and such market value is greater or less than the cost of the property given in exchange. However, if the property was acquired prior to March 1, 1913, the amount of taxable gain or deductible loss shall be determined in accordance with article 1561 as amended. For the rule applicable where a corporation, in connection with a reorganization, merger, or consolidation, exchanges property for stock, see article 1567. (T. D. 3206; approved July 28, 1921, amending art. 1566, Reg. 45.)

ART. 1568. **Determination of gain or loss from subsequent sale.**—The new stock and securities received, as described in the preceding article, take the place of the old stock and securities. For the purpose, therefore, of ascertaining the gain derived or loss sustained from the subsequent sale of any stock of A or of the consolidated corporation, so received, the original cost to the taxpayer of the stock of B or A in respect of which the new stock was issued, less any untaxed distribution made to the taxpayer by A out of the former capital or surplus of B, or by the consolidated corporation out of the former capital or surplus of A or B, is the basis for determining the amount of such gain or loss. However, the gain which is taxable or the loss which is deductible in the case of the subsequent sale of any stock of A or of the consolidated corporation, so received, when the stock of B or A in respect of which new stock was issued was acquired prior to March 1, 1913, shall be determined in accordance with the provisions of article 1561 as amended. When securities of a single class are exchanged for new securities of the same total par value but of different classes for the purpose of determining profit or loss on the subsequent sale of any of the new securities, the proportion of the original cost to be allocated to each class of new securities is that proportion which the market value of the particular class bears to the market value of all securities received on the date of the exchange. If the securities exchanged were acquired prior to March 1, 1913, the proportion of their value as of such date to be allocated to each class of new securities is that proportion which the market value of the particular class bears to the market value of all securities received on the date of the exchange and the gain or loss shall be determined in accordance with the provisions of article 1561 as amended. For example, if 100 shares of common stock, par value $100, are exchanged for 50 shares of preferred and 50 shares of common each of $100 par value, and the cost of the old stock was $250 per share, or $25,000, but the market value of the preferred on the date of the exchange was $110 per share, or $5,500 for the 50 shares, and the market value of the common was $440 per share or $22,000 for the 50 shares of common, one-fifth of the original cost, or $5,000, would be regarded as the cost of the preferred and four-fifths, or $20,000, as the cost of common. The same method of computation should be used in the case of stock acquired prior to March 1, 1913, in order to ascertain the proportion of such value to be allocated to each class of new securities on that date and the taxable gain or deductible loss should thereafter be computed in accordance with article 1561 as amended. Similarly, the cost after reorganization, merger, or consolidation of the assets of A, or of the consolidated corporation, is the sum of the cost of the assets of A and B for the purpose of ascertaining the gain or loss from a subsequent sale. However, in case the assets were acquired prior to March 1, 1913, in order to compute the taxable gain or deductible loss under article 1561 as amended, the fair market value as of such date should also be ascertained by taking the sum of the fair market value of the assets of A and B. The new invested capital of A, or of the consolidated corporation, is to be determined as if A and B were rendering a consolidated return as affiliated corporations. See sections 240 and 326 of the statute and articles 631–638 and 864–869. (T. D. 3206; approved July 28, 1921, amending art. 1568, Reg. 45.)

ART. 1569. **Exchange of stock for other stock of greater par value.**—If in the case of any reorganization, merger, or consolidation, the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock or securities exchanged, income will be realized from the transaction by the recipients of the new stock or securities to an amount limited by (*a*) the excess of the par or face value of the new stock or securities over the par or face value of the old, and (*b*) the excess of the fair market value of the new stock or securities over the cost of the old, unless the old stock or securities were acquired prior to March 1, 1913, and their fair market price or value as of that date was greater than their cost, in which case the fair market value of the new stock or securities must be in excess of the fair market value as of March 1, 1913, of the old. The taxable profit will be (*a*) or (*b*), whichever is less. On a subsequent sale of the new stock or securities their cost to the taxpayer will be the cost of the old stock or securities plus the profit taxed on the exchange. (T. D. 3206; approved July 28, 1921, amending art. 1569, Reg. 45.)

ART. 1570. **Readjustment of partnership interests.**—When a partner retires from a partnership, or it is dissolved, he realizes a gain or loss measured by the difference between the price received for his interest and the cost to him of his interest in the partnership, including in such cost the amount of his share in any undistributed partnership net income earned since he became a partner, on which the income tax has been paid. However, if such interest in the partnership was acquired prior to March 1, 1913, both the cost as hereinbefore provided and the value of such interest as of such date, plus the amount of the share in any undistributed partnership net income earned since February 28, 1913, on which the income tax has been paid, shall be ascertained and the taxable gain derived or the deductible loss sustained shall be computed as provided in article 1561 as amended. If the partnership distributes its assets in kind and not in cash, the partner realizes no gain or loss until he disposes of the property received on liquidation. See article 1566 as amended. Whenever a new partner is admitted to a partnership, or any existing partnership is reorganized, the facts as to such change or reorganization should be fully set forth in the next return of income, in order that the Commissioner may determine whether any gain or loss has been realized by any partner. See also article 1563. (T. D. 3206; approved July 28, 1921, amending art. 1570, Reg. 45.)

ART. 1581. **Need of inventories.**—In order to reflect the net income correctly, inventories at the beginning and end of each year are necessary in every case in which the production, purchase, or sale of merchandise is an income-producing factor. The inventory should include raw materials and supplies on hand that have been acquired for sale, consumption, or use in productive processes, together with all finished or partly finished goods. Only merchandise, title to which is vested in the taxpayer, should be included in the inventory. Accordingly, the seller should include in his inventory goods under contract for sale but not yet segregated and applied to the contract and goods out upon consignment, but should exclude from inventory goods sold, title to which has passed to the purchaser. A purchaser should include in inventory merchandise purchased, title to which has passed to him, although such merchandise is in transit or for other reasons has not been reduced to physical possession, but should not include goods ordered for future delivery, transfer of title to which has not yet been effected. (T. D. 3296; approved March 3, 1922, amending art. 1581, Reg. 45.)

ART. 1582. **Valuation of inventories.**—The act provides two tests to which each inventory must conform: (1) It must conform as nearly as may be to the best accounting practice in the trade or business, and (2) it must clearly reflect the income. It follows, therefore, that inventory rules can not be uniform, but must give effect to trade customs which come within the scope of the best accounting practice in the particular trade or business. In order to clearly reflect income the inventory practice of a taxpayer should be consistent from year to year, and greater weight is to be given to consistency than to any particular method of inventorying or basis of valuation, so long as the method or basis used is substantially in accord with the regulations. An inventory that can be used under the best accounting practice in a balance sheet showing the financial position of the taxpayer can, as a general rule, be regarded as clearly reflecting his income.

The basis of valuation most commonly used by business concerns and which meets the requirements of the revenue act is (*a*) cost or (*b*) cost or market, whichever is lower. (For inventories by dealers in securities, see art. 1585.) Any goods in an inventory which are unsalable at normal prices or unusable in the normal way because of damage, imperfections, shop wear, changes of style, odd or broken lots, or other similar causes, including secondhand goods taken in exchange, should be valued at bona fide selling prices less cost of selling, whether basis (*a*) or (*b*) is used, or if such goods consist of raw materials or partly finished goods held for use or consumption, they should be valued upon a reasonable basis, taking into consideration the usability and the condition of the goods, but in no case shall such value be less than the scrap value. Bona fide selling price means actual offerings of goods during a period ending not later than 30 days after inventory date. The burden of proof will rest upon the taxpayer to show that such exceptional goods as are valued upon such selling basis come within the classifications indicated above, and he shall maintain such records of the disposition of the goods as will enable a verification of the inventory to be made.

In respect to normal goods, whichever basis (*a*) or (*b*) is adopted must be applied with reasonable consistency to the entire inventory. Taxpayers were given an option to adopt the basis of either (*a*) cost or (*b*) cost or market, whichever is lower, for their 1920 inventories, and the basis adopted for that year is controlling, and a change can now be made only after permission is secured from the commissioner. Goods taken in the inventory which have been so intermingled that they can not be identified with specific invoices will be deemed to be either (*a*) the goods most recently purchased or produced, and the cost thereof will be the actual cost of the goods purchased or produced during the period in which the quantity of goods in the inventory has been acquired, or (*b*) where the taxpayer maintains book inventories in accordance with a sound accounting system in which the respective inventory accounts are charged with the actual cost of the goods purchased or produced and credited with the value of goods used, transferred, or sold, calculated upon the basis of the actual cost of the goods acquired during the taxable year (including the inventory at the beginning of the year), the net value as shown by such inventory accounts will be deemed to be the cost of the goods on hand. The balances shown by such book inventories should be verified by physical inventories at reasonable intervals and adjusted to conform therewith.

Inventories should be recorded in a legible manner, properly computed and summarized, and should be preserved as a part of the accounting record of the taxpayer. The inventories of taxpayers on whatever basis taken will be subject to investigation by the commissioner, and the taxpayer must satisfy the commissioner of the correctness of the prices adopted.

The following methods, among others, are sometimes used in taking or valuing inventories, but are not in accord with these regulations, viz:

(*a*) Deducting from the inventory a reserve for price changes, or an estimated depreciation in the value thereof.

(*b*) Taking work in process, or other parts of the inventory, at a nominal price or at less than its proper value.

(*c*) Omitting portions of the stock on hand.

(*d*) Using a constant price or nominal value for a so-called normal quantity of materials or goods in stock.

(*e*) Including stock in transit, either shipped to or from the taxpayer, the title of which is not vested in the taxpayer. (T. D. 3296; approved March 3, 1922, amending art. 1582, Reg. 45.)

ART. 1583. **Inventories at cost.**—Cost means:

(1) In the case of merchandise on hand at the beginning of the taxable year, the inventory price of such goods.

(2) In the case of merchandise purchased since the beginning of the taxable year, the invoice price less trade or other discounts, except strictly cash discounts, approximating a fair interest rate, which may be deducted or not at the option of the taxpayer, provided a consistent course is followed. To this net invoice price should be added transportation or other necessary charges incurred in acquiring possession of the goods.

(3) In the case of merchandise produced by the taxpayer since the beginning of the taxable year (*a*) the cost of raw materials and supplies entering into or consumed in connection with the product, (*b*) expenditures for direct labor, (*c*) indirect expenses incident to and necessary for the production of the particular article, including in such indirect expenses a reasonable proportion of management expenses, but not including any cost of selling or return on capital, whether by way of interest or profit.

(4) In any industry in which the usual rules for computation of cost production are inapplicable, costs may be approximated upon such basis as may be reasonable and in conformity with established trade practice in the particular industry. Among such cases are (*a*) farmers and raisers of live stock (see art. 1586), (*b*) miners and manufacturers who by a single process or uniform series of processes derive a product of two or more kinds, size or grade, the unit cost of which is substantially alike (see art. 1587), and retail merchants who use what is known as the "retail method" in ascertaining approximate cost. See art. 1588. (T. D. 3296; approved March 3, 1922, amending art. 1583, Reg. 45.)

ART. 1584. **Inventories at market.**—Under ordinary circumstances, and for normal goods in an inventory, "market" means the current bid price prevailing at the date of the inventory for the particular merchandise in the volume in which usually purchased by the taxpayer, and is applicable in the cases (*a*) of goods purchased and on hand, and (*b*) of basic elements of cost (materials, labor, and burden) in goods in process of manufacture and in finished goods on hand; exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sales contracts (i. e., those not legally subject to cancellation by either party) at fixed prices entered into before the date of the inventory, which goods must be inventoried at cost. Where no open market exists or where quotations are nominal due to stagnant market conditions, the taxpayer must use such evidence of a fair market price at the date or dates nearest the inventory as may be available, such as specific purchases or sales by the taxpayer or others in reasonable volume and made in good faith, or compensation paid for cancellation of contracts for purchase commitments. Where the taxpayer in the regular course of business has offered for sale such merchandise at prices lower than the current price as above defined, the inventory may be valued at such prices less proper allowance for selling expense, and the correctness of such prices will be determined by reference to the actual sales of the taxpayer for a reasonable period before and after the date of the inventory. Prices which vary materially from the actual prices so ascertained will not be accepted as reflecting the market. It is recognized that in the latter part of 1918, by reason among other things of governmental control not having been relinquished, conditions were abnormal and in many commodities there was no such scale of trading as to establish a free market. In such a case, when a market was established during the succeeding year, a claim may be filed for any loss sustained in accordance with the provisions of section 214 (*a*) (12) or section 234 (*a*) (14) of the statute. (See arts. 261–268.) (T. D. 3296; approved March 3, 1922, amending art. 1584, Reg. 45.)

ART. 1585. **Inventories by dealers in securities.**—A dealer in securities, who in his books of account regularly inventories unsold securities on hand, either (*a*) at cost or (*b*) at cost or market, whichever is lower, or (*c*) at market value, may make his return upon the basis upon which his accounts are kept; provided that a description of the method employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years, unless another be authorized by the commissioner. For the purpose of this rule, a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers; that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation, and not in the course of an established business, and officers of corporations and members of partnerships, who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule. A dealer in securities is not entitled to the benefits of section 206 with reference to the gain from the sale of securities. (T. D. 3296; approved March 3, 1922, amending art. 1585, Reg. 45.)

ART. 1586. **Inventories of live-stock raisers and other farmers.**—(1) Farmers may change the basis of their returns from that of receipts and disbursements to that of an inventory basis provided adjustments are made in accordance with one of the two methods outlined in (A) and (B) below. It is optional with the taxpayer which method is used, but having elected one method the option so exercised will be binding upon the taxpayer and he will be precluded from filing amended returns upon the basis of the other method.

(A) Opening and closing inventories shall be used for the year in which the change is made. There should be included in the opening inventory all farm products (including live stock) purchased or raised which were on hand at the date of the inventory and there must be submitted with the return for the current taxable year an adjustment sheet for the preceding taxable year based on the inventory method, upon the amount of which adjustment the tax shall be assessed and paid (if any be due) at the rate of tax in effect for that year. Ordinarily an adjustment sheet for the preceding year will be sufficient, but if, in the opinion of the commissioner, such adjustment is not sufficient to clearly reflect income, adjustments for earlier years may be accepted or required. Where it is impossible to render complete inventories for the preceding year or years, the department will accept estimates which, in its opinion, substantially reflect the income on the inventory basis for such preceding year or years; but inventories must not include real estate, buildings, permanent improvements, or any other assets subject to depreciation.

(B) No adjustment sheets will be required, but the net income for the taxable year in which the change is made must be computed without deducting from the sum of the closing inventory and the sales and other receipts, the inventory of live stock, crops, and products at the beginning of the year; provided, however,

(*a*) That if any live stock, grain, or other property on hand at the beginning of the taxable year has been purchased and the cost thereof not charged to expense, only the difference between the cost and the selling price should be reported as income for the year in which sold;

(*b*) But if the cost of such property has been charged to expense for a previous year, the entire amount received must be reported as income for the year in which sold.

(2) Because of the difficulty of ascertaining actual cost of live stock and other farm products, farmers who render their returns upon an inventory basis may at their option value their inventories for the current taxable year according to the "farm-price method," which provides for the valuation of inventories at market price less cost of marketing. If the use of the "farm-price method" of valuing inventories for any taxable year involves a change in method of pricing inventories from that employed in prior years, the opening inventory for the taxable year in which the change is made should be brought in at the same value as the closing inventory for the preceding taxable year. If such valuation of the opening inventory for the taxable year in which the change is made results in an abnormally large income for that year, there may be submitted with the return for such taxable year an adjustment statement for the preceding year based on the "farm-price method" of valuing inventories, upon the amount of which adjustments the tax, if any be due, shall be assessed and paid at the rate of tax in effect for such preceding year. If an adjustment for the preceding year is not, in the opinion of the commissioner, sufficient to clearly reflect income, adjustment sheets for prior years may be accepted or required.

Where returns have been made in which the taxable net income has been computed upon incomplete inventories, the abnormality should be corrected by submitting with the return for the current taxable year a statement for the preceding year in which such adjustments shall be made as are necessary to bring the closing inventory for the preceding year into agreement with the opening complete inventory for the current taxable year. If necessary to clearly reflect income, similar adjustments may be made as at the beginning of the preceding year or years and the tax, if any be due, shall be assessed at the rate of tax in effect for such year or years. (T. D. 3399; approved October 7, 1922, amending art. 1586, Reg. 45, as amended by T. D. 3296.)

ART. 1587. **Inventories of miners and manufacturers.**—A taxpayer engaged in mining or manufacturing who by a single process or uniform series of processes derives a product of two or more kinds, sizes, or grades, the unit cost of which is substantially alike, and who in conformity to a recognized trade practice allocates an amount of cost to each kind, size, or grade of product which in the aggregate will absorb the total cost of production, may use such allocated cost as a basis for pricing inventories, provided such allocation bears a reasonable relation to the respective selling values of the different kinds of product. (T. D. 3296; approved March 3, 1922, amending art. 1587, Reg. 45.)

ART. 1588. **Inventories of retail merchants.**—Retail merchants who employ what is known as the "retail method" of pricing inventories may make their returns upon that basis, provided that the use of such method is designated upon the return, that accurate accounts are kept, and that such method is consistently adhered to unless a change is authorized by the commissioner. Under this method the goods in the inventory are ordinarily priced at the selling prices and the total retail value of the goods in each department or of each class of goods is reduced to approximate cost by deducting the percentage which represents the difference between the retail selling value and the purchase price. This percentage is determined by departments of a store or by classes of goods, and should represent as accurately as may be the amounts added to the cost prices of the goods to cover selling and other expenses of doing business and for the margin of profit. In computing the percentage above mentioned proper adjustment should be made for all mark-ups and markdowns.

A taxpayer maintaining more than one department in his store or dealing in classes of goods carrying different percentages of gross profit should not use a percentage and profit based upon an average of his entire business but should compute and use in valuing his inventory the proper percentages for respective departments or classes of goods. (T. D. 3296; approved March 3, 1922, amending art. 1588, Reg. 45.)

ART. 1721. **When fractional part of cent may be disregarded.**—In the payment of taxes a fractional part of a cent shall be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to one cent. Fractional parts of a cent should not be disregarded in the computation of taxes. (T. D. 3250; approved November 18, 1921, amending art. 1721, Reg. 45.)

ART. 1731. **Payment of tax by certificates of indebtedness.**[1]—Collectors of internal revenue are authorized and directed to receive at par United States Treasury certificates of indebtedness of Series TM-1922, dated March 15, 1921, Series TM2–1922, dated August 1, 1921, and Series TM3–1922, dated September 15, 1921, all maturing March 15, 1922, in payment of income and profits taxes payable on March 15, 1922. Collectors are authorized and directed to receive at par Treasury certificates of indebtedness of Series TJ–1922, dated June 15, 1921, and Series TJ2–1922, dated December 15, 1921, both maturing June 15, 1922, in payment of income and profits taxes payable on June 15, 1922; Treasury certificates of indebtedness of Series TS–1922, dated September 15, 1921, and Series TS2–1922, dated

[1] Treasury Decisions 3115 and 3143 relative to acceptance of certificates of indebtedness in payment of income and profits taxes for the calendar year 1920, are printed as follows: T. D. 3115 (C. B. 4, p. 415); T. D. 3143 (C. B. 4, p. 417).

November 1, 1921, both maturing September 15, 1922, in payment of income and profits taxes payable on September 15, 1922; and Treasury certificates of indebtedness of Series TD-1922, dated December 15, 1921, maturing December 15, 1922, in payment of income and profits taxes payable on December 15, 1922. Collectors are further authorized and directed to receive at par, in payment of income and profits taxes payable at the maturity of the certificates, respectively, Treasury certificates of indebtedness of any other series which may be issued maturing on March 15, June 15, September 15, or December 15, 1922, respectively, and expressed to be acceptable in payment of income and profits taxes. (T. D. 3280; approved February 7, 1922, amending art. 1731, Reg. 45.)

ART. 1732. **Procedure with respect to certificates of indebtedness.**—Collectors are not authorized hereunder to receive in payment of income or profits taxes any Treasury certificates of indebtedness not expressed to be acceptable in payment of income and profits taxes, nor any Treasury certificates maturing on a date other than the date on which the taxes are payable. Collectors are authorized to receive Treasury certificates of indebtedness which are acceptable as herein provided in payment of income and profits taxes, in advance of the respective dates on which the certificates mature. Treasury certificates acceptable in payment of income and profits taxes have one or more interest coupons attached, including as to each series a coupon payable at the maturity of the certificates, but all interest coupons must in each case be detached by the taxpayer before presentation to the collector, and collected in ordinary course when due. The amount, at par, of the Treasury certificates of indebtedness presented by any taxpayer in payment of income and profits taxes must not exceed the amount of the taxes to be paid by him, and collectors shall in no case pay interest on the certificates or accept them for an amount other or greater than their face value.

Deposits of Treasury certificates of indebtedness received in payment of income and profits taxes must be made by collectors, unless otherwise specifically instructed by the Secretary of the Treasury, with the Federal reserve bank of the district in which the collector's head office is located, or in case such head office is located in the same city with a branch Federal reserve bank, with such branch Federal reserve bank. Specific instructions may be given to collectors by the Secretary of the Treasury in certain instances for the deposit of the certificates with Federal reserve banks of other districts and branch Federal reserve banks. The term "Federal reserve bank" where it appears herein, unless otherwise indicated by the context, includes branch Federal reserve banks. Treasury certificates accepted by the collector prior to the dates when the certificates respectively mature, should be forwarded by the collector to the Federal reserve bank to be held for account of the collector until the date of maturity, and for deposit on such date.

Collectors of internal revenue are not authorized, unless express instructions otherwise are given by the Secretary of the Treasury, to receive in payment of income or profits taxes interim receipts issued by Federal reserve banks in lieu of definitive certificates of the series herein described.

Certificates of indebtedness should in all cases be indelibly stamped on the face thereof as follows by the collectors, and when so stamped should be delivered to the Federal reserve bank in person if the collector is located in the same city, and in all other cases forwarded by registered mail uninsured:

_______________________________, 192__

This certificate has been accepted in payment of income and profits taxes and will not be redeemed by the United States except for credit of the undersigned.

_______________________________,

Collector of Internal Revenue
for the ___________ district of ___________

Collectors should make in tabular form a schedule in duplicate of the certificates of indebtedness to be forwarded to the Federal reserve bank, showing the serial number of each certificate, the date of issue and maturity, with serial designation, and face value. Certificates of indebtedness accepted prior to the date of maturity must be scheduled separately. At the bottom of each schedule there should be written or stamped "Income and Profits Taxes $__________," which amount must agree with the total shown on the schedule. One copy of this schedule must accompany certificates sent to the Federal reserve bank, and the other be retained by the collector. The income and profits tax deposits resulting from the deposits of such certificates must in all cases be shown on the face of the certificate of deposit (national-bank Form 15) separate and distinct from the item of miscellaneous internal-revenue collections (formerly called Ordinary). Until certificates of deposit are received from the Federal reserve banks, the amounts represented by the certificates of indebtedness forwarded for deposit must be carried by collectors as cash on hand, and not credited as collections, as the dates of certificates of deposit determine the dates of collections.

For the purpose of saving taxpayers the expense of transmitting such certificates as are held in Federal reserve cities or Federal reserve branch bank cities to the office of the collector in whose district the taxes are payable, taxpayers desiring to pay income and profits taxes by such Treasury certificates of indebtedness acceptable in payment of taxes should communicate with the collector of the district in which the taxes are payable and request from him authority to deposit such certificates with the Federal reserve bank in the city in which the certificates are held. Collectors are authorized to permit deposits of Treasury certificates of indebtedness in any Federal reserve bank with the distinct understanding that the Federal reserve bank is to issue a certificate of deposit in the collector's name covering the amount of the certificates of indebtedness at par and to state on the face of the certificate of deposit that the amount represented thereby is in payment of income and profits taxes. The Federal reserve bank should forward the original certificate of deposit to the Treasurer of the United States, with its daily transcript, and transmit to the collector the duplicate and triplicate, accompanied by a statement giving the name of the taxpayer for whom the payment is made in order that the collector may make the necessary record and forward the duplicate to the office of the Commissioner of Internal Revenue. (T. D. 3280; approved February 7, 1922, amending art. 1732, Reg. 45.)

ART. 1800. **Promulgation of regulations.**

Where any case in the Bureau of Internal Revenue has been finally closed after the taxpayer, or other party thereto, has had a hearing or has been afforded by written notice an opportunity to present oral or written arguments or statements of fact in support of his contentions, the case will not be reopened except (1) where a showing is made of new and material facts, accompanied by an explanation, satisfactory to the Commissioner of Internal Revenue, of the failure to produce such facts prior to the closing of the case, or (2) where the case is materially affected by the change of regulations or by the final decision of another case either by the Commissioner of Internal Revenue or by a court of competent jurisdiction. The application for reopening a case should be addressed to the Commissioner of Internal Revenue, should state succinctly the facts and circumstances upon which the application is based, and must be supported by the affidavit of a person having knowledge of the facts.

This decision is not to be construed as modifying the regulations relating to the filing of claims in abatement or claims for refund, nor as denying the right of a taxpayer to a hearing or to an appeal at any stage of his case until the case has been finally closed. After the taxpayer has exhausted his remedies within the bureau, however, and the case has been finally closed, it will be reopened only under the conditions stated in the decision. (T. D. 3240; approved October 31, 1921, relating to art. 1800, Reg. 45.)

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