

(T. D. 3295.)

Regulations No. 62 (1922 ed.), relating to the income tax and war profits and excess profits tax under the revenue act of 1921.

PART I.**INCOME TAX ON INDIVIDUALS.****NORMAL TAX.**

SEC. 210. That, in lieu of the tax imposed by section 210 of the Revenue Act of 1918, there shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax of 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.**—Except as otherwise provided, Title I of the statute is effective January 1, 1921, and 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, determined by 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, 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 on corporations an income tax at a fixed rate, and, for the calendar year 1921 only, an excess profits tax. 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.**—The normal income tax on individual citizens or residents of the United States is at the rate of 4 per cent upon the first \$4,000 of net income subject to the normal tax 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 is 8 per cent and there is no reduction of the rate upon the first \$4,000 of net income. 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 301-306.

ART. 3. Persons liable to tax.—Citizens of the United States except those entitled to the benefits of section 262 (see arts. 1135-1137), wherever resident, are liable to the tax. It makes no difference that they 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 92-94. Estates and trusts are also subject to the tax. See section 219 and articles 341-348.

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 311-314.

SURTAX.

SEC. 211. (a) That, in lieu of the tax imposed by section 211 of the Revenue Act of 1913, 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—

(1) For the calendar year 1921, 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 ;

(2) For the calendar year 1922 and each calendar year thereafter, a surtax equal to the sum of the following :

1 per centum of the amount by which the net income exceeds \$6,000 and does not exceed \$10,000 ;

- 2 per centum of the amount by which the net income exceeds \$10,000 and does not exceed \$12,000;
- 3 per centum of the amount by which the net income exceeds \$12,000 and does not exceed \$14,000;
- 4 per centum of the amount by which the net income exceeds \$14,000 and does not exceed \$16,000;
- 5 per centum of the amount by which the net income exceeds \$16,000 and does not exceed \$18,000;
- 6 per centum of the amount by which the net income exceeds \$18,000 and does not exceed \$20,000;
- 8 per centum of the amount by which the net income exceeds \$20,000 and does not exceed \$22,000;
- 9 per centum of the amount by which the net income exceeds \$22,000 and does not exceed \$24,000;
- 10 per centum of the amount by which the net income exceeds \$24,000 and does not exceed \$26,000;
- 11 per centum of the amount by which the net income exceeds \$26,000 and does not exceed \$28,000;
- 12 per centum of the amount by which the net income exceeds \$28,000 and does not exceed \$30,000;
- 13 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 \$36,000;
- 16 per centum of the amount by which the net income exceeds \$36,000 and does not exceed \$38,000;
- 17 per centum of the amount by which the net income exceeds \$38,000 and does not exceed \$40,000;
- 18 per centum of the amount by which the net income exceeds \$40,000 and does not exceed \$42,000;
- 19 per centum of the amount by which the net income exceeds \$42,000 and does not exceed \$44,000;
- 20 per centum of the amount by which the net income exceeds \$44,000 and does not exceed \$46,000;
- 21 per centum of the amount by which the net income exceeds \$46,000 and does not exceed \$48,000;
- 22 per centum of the amount by which the net income exceeds \$48,000 and does not exceed \$50,000;
- 23 per centum of the amount by which the net income exceeds \$50,000 and does not exceed \$52,000;
- 24 per centum of the amount by which the net income exceeds \$52,000 and does not exceed \$54,000;
- 25 per centum of the amount by which the net income exceeds \$54,000 and does not exceed \$56,000;
- 26 per centum of the amount by which the net income exceeds \$56,000 and does not exceed \$58,000;
- 27 per centum of the amount by which the net income exceeds \$58,000 and does not exceed \$60,000;
- 28 per centum of the amount by which the net income exceeds \$60,000 and does not exceed \$62,000;
- 29 per centum of the amount by which the net income exceeds \$62,000 and does not exceed \$64,000;
- 30 per centum of the amount by which the net income exceeds \$64,000 and does not exceed \$66,000;

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

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

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

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

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

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

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

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

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

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

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

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

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

44 per centum of the amount by which the net income exceeds \$92,000 and does not exceed \$94,000 ;

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

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

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

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

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

50 per centum of the amount by which the net income exceeds \$200,000.

(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, for the calendar year 1921, 20 per centum, and for each calendar year thereafter 16 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. As to optional method of taxation of

capital net gain, applicable to 1922 and succeeding years only, see section 206 and articles 1651-1653.

ART. 12. **Computation of surtax.**—The following tables show the surtax (1) for the calendar year 1921 (no change from previous rates) and (2) for 1922 and subsequent years, 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.

I. TABLE FOR 1921.

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
\$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

I. TABLE FOR 1921—Continued.

Net income.	Per cent.	Surtax.	Total surtax.
\$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		

II. TABLE FOR 1922 AND SUBSEQUENT YEARS.

Net income.	Per cent.	Surtax.	Total surtax.
\$6,000 to \$10,000.....	1	\$40	\$40
\$10,000 to \$12,000.....	2	40	80
\$12,000 to \$14,000.....	3	60	140
\$14,000 to \$16,000.....	4	80	220
\$16,000 to \$18,000.....	5	100	320
\$18,000 to \$20,000.....	6	120	440
\$20,000 to \$22,000.....	8	160	600
\$22,000 to \$24,000.....	9	180	780
\$24,000 to \$26,000.....	10	200	980
\$26,000 to \$28,000.....	11	220	1,200
\$28,000 to \$30,000.....	12	240	1,440
\$30,000 to \$32,000.....	13	260	1,700
\$32,000 to \$36,000.....	15	600	2,300
\$36,000 to \$38,000.....	16	320	2,620
\$38,000 to \$40,000.....	17	340	2,960
\$40,000 to \$42,000.....	18	360	3,320
\$42,000 to \$44,000.....	19	380	3,700
\$44,000 to \$46,000.....	20	400	4,100
\$46,000 to \$48,000.....	21	420	4,520
\$48,000 to \$50,000.....	22	440	4,960
\$50,000 to \$52,000.....	23	460	5,420
\$52,000 to \$54,000.....	24	480	5,900
\$54,000 to \$56,000.....	25	500	6,400
\$56,000 to \$58,000.....	26	520	6,920
\$58,000 to \$60,000.....	27	540	7,460
\$60,000 to \$62,000.....	28	560	8,020
\$62,000 to \$64,000.....	29	580	8,600
\$64,000 to \$66,000.....	30	600	9,200
\$66,000 to \$68,000.....	31	620	9,820
\$68,000 to \$70,000.....	32	640	10,460
\$70,000 to \$72,000.....	33	660	11,120
\$72,000 to \$74,000.....	34	680	11,800
\$74,000 to \$76,000.....	35	700	12,500
\$76,000 to \$78,000.....	36	720	13,220
\$78,000 to \$80,000.....	37	740	13,960
\$80,000 to \$82,000.....	38	760	14,720
\$82,000 to \$84,000.....	39	780	15,500

II. TABLE FOR 1922 AND SUBSEQUENT YEARS—Continued.

Net income.	Per cent.	Surtax.	Total surtax.
\$84,000 to \$86,000.....	40	\$800	\$16,300
\$86,000 to \$88,000.....	41	820	17,120
\$88,000 to \$90,000.....	42	840	17,960
\$90,000 to \$92,000.....	43	860	18,820
\$92,000 to \$94,000.....	44	880	19,700
\$94,000 to \$96,000.....	45	900	20,600
\$96,000 to \$98,000.....	46	920	21,520
\$98,000 to \$100,000.....	47	940	22,460
\$100,000 to \$150,000.....	48	24,000	46,460
\$150,000 to \$200,000.....	49	24,500	70,960
\$200,000 up.....	50

The surtax for any amount of net income not shown in the above tables 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 for calendar year 1921 is the sum of \$8,690 (the surtax upon \$62,000 as shown by Table I) plus 30 per cent of \$1,128, or \$338.40, making a total surtax of \$9,028.40. For calendar year 1922 the surtax upon the same amount of net income would be \$8,347.12.

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 for the calendar year 1921, 20 per cent, and for subsequent calendar years 16 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 for the calendar year 1921, 20 per cent and for subsequent calendar years 16 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 OF INDIVIDUALS 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.

(c) 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. Income can not be determined merely by reckoning cash receipts, 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, 206, 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 71-91. (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 301-306. The surtax is imposed upon net income; the normal tax upon net income less credits. Though taxable net income is a statutory conception it follows, subject to certain modifications as to exemptions and as to deductions for partial losses in some cases, 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 51. 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. 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 sale or conversion of the property. But see section 203.

(2) For the taxable year 1921, the true income, computed under the Revenue Act of 1921 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. 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.

(3) A taxpayer who changes the method of accounting employed in keeping his books for the taxable year 1921 or thereafter should, 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 before the close of the period to be covered by 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 have placed the discount account upon an accrual basis will be permitted to submit (or the Commissioner may require) amended returns for the prior year affected. 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 1921.

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 1300 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 arts. 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 added to the property account or charged against the appropriate reserve and not to current expenses. But see article 222.

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 1921 is the calendar year 1921 or any fiscal year ending during the calendar year 1921. See section 200 of the statute. A person having no such fiscal year must make return on the basis of the calendar year. Except in the case 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 his accounting period.

ART. 26. Change in accounting period.—If a taxpayer changes his 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 30 days before the close of the proposed or new taxable year or period. 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 and compute his net income upon the basis of the new accounting period. 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, 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 items (except as provided in subdivision (e) of section 201) 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). 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. Profits of citizens, residents, or domestic corporations derived from sales in foreign commerce must be included in their gross income; but special provisions are made for nonresident aliens by section 217 and for citizens and domestic corporations deriving at least 80 per cent of their gross income from sources within possessions of the United States by section 262. Income may be in the form of cash or of property. A husband and wife domiciled in Texas, Washington, Arizona, Idaho, New Mexico, Louisiana, and Nevada, in rendering separate income tax returns, may each report as gross income one-half of the income which, under the laws of the respective States, becomes simultaneously with its receipt community property. As to dividends, whether in cash or in property, see section 201 and articles 1541-1549. Under the Revenue Act of 1918 the amount of income tax paid for a bondholder by the obligor pursuant to a so-called tax-free covenant in its bonds was treated as additional interest paid the bondholder who was required to include it in his gross income; but section 234(a) (3) of the Revenue Act of 1921 provides that a bondholder shall not include such amount in his gross income. Under both statutes the bondholder is entitled to credit such amount against his total income tax otherwise due. See section 221(b) of the statute and article 375. As to the basis for determining gain or loss from sale or disposition of property, see section 202 and articles 1561-1570. As to the gross income of corporations, see section 233 and articles 541-550.

ART. 32. Compensation for personal services.—Where no determination of compensation is had until the completion of the services, the amount received is ordinarily 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, pay of persons in the military or naval forces of the United States, retired pay of Federal and other officers, and pensions or retiring allowances paid by private persons or by the United States (except war pensions exempted by paragraph 9 of subdivision (b) of section 213), 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 a new tax or an increased tax if elected or appointed to office prior to the passage of the taxing statute. The Revenue Act of 1921, however, imposes no new or increased tax upon such salaries; hence the salaries of all Federal judges appointed since February 24, 1919, are subject to the tax imposed by the Revenue Act of 1921. See article 88 as to compensation of State officers and employees.

ARR. 33. Compensation paid other than in cash.—Where services are paid for with something other than money, the fair market value, if readily realizable, 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 employees, 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. But see section 213(b) (11). 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.

ARR. 34. Compensation paid in notes.—Notes or other evidences of indebtedness 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,

shall 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 6 or 7 per cent basis, the recipient shall 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.

ART. 36. Long-term contracts.—Income from long-term contracts is taxable for the period in which the income is determined, such determination depending upon the nature and terms of the particular contract. As used herein the term “long-term contracts” means building, installation, or construction contracts covering a period in excess of one year. Persons whose income is derived in whole or in part from such contracts may, as to such income, prepare their returns upon the following bases:

(a) Gross income derived from such contracts may be reported upon the basis of percentage of completion. In such case there should accompany the return certificates of architects or engineers showing the percentage of completion during the taxable year of the entire work to be performed under the contract. There should be deducted from such gross income all expenditures made during the taxable year on account of the contract, account being taken of the material and supplies on hand at the beginning and end of the taxable period for use in connection with the work under the contract but not yet so applied. If, upon completion of a contract, it is found that the taxable net income arising thereunder has not been clearly reflected for any year or years, the Commissioner may permit or require an amended return.

(b) Gross income may be reported in the taxable year in which the contract is finally completed and accepted if the taxpayer elects as a consistent practice to so treat such income, provided such method clearly reflects the net income. If this method is adopted there should be deducted from gross income all expenditures during the life of the contract which are properly allocated thereto, taking into consideration any material and supplies charged to the work under the contract but remaining on hand at the time of completion.

Where a taxpayer has filed his return in accordance with the method of accounting regularly employed by him in keeping his books and such method clearly reflects the income, he will not be required to change to either of the methods above set forth. If a taxpayer desires to change his method of accounting in accordance with paragraphs (a) and (b) above, a statement showing the composition of all items appearing upon his balance sheet and used in connection with the method of accounting formerly employed by him, should accompany his return.

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 fair market value of such warrants should 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 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, and if he realizes more than the value of the warrants so returned he should include such amount in his gross income of the year in which realized.

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 live stock and produce which 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 and allowable as a deduction in computing net income.

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 and allowable as a deduction in computing net income, 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 included in gross 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 should 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 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 to be included in gross income 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 1548. 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 1567. The entire amount realized from the sale of rights to subscribe for stock is income, but no income is realized from the exercise of the right to subscribe.

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. 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. 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. If specific payment was not made for good will acquired after February 28, 1913, there can be no deductible loss with respect thereto, but profit may be realized from the sale of good will built up through expenditures which have been currently deducted. 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. 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 repos-

sesses 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 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 constitute 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.

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 having a readily realizable market value, 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 having a readily realizable market value 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. If these obligations have a readily realizable market value, as defined by article 1564, they are to be considered as the equivalent of cash and the profit realized from the transaction is taxable income for the year in which the initial payment was made and the obligation 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 arts. 161 and 162). If the obligations have no readily realizable market value, the amount of the initial payment shall be applied against and reduce the basis, as provided in section 202 and articles 1561–1564, of the property sold and if in excess of such basis, shall be taxable to the extent of the excess. See article 1568. Gain or loss is realized when the obligations are disposed of or satisfied, the amount being the difference between the basis as provided above and the amount realized therefor. See articles 153, 1561, and 1568.

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. Distribution 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 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 may at his option report the income therefrom upon either of the following bases:

(a) The lessor may report as income at the time when such buildings or improvements are completed 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.

(b) The lessor may spread over the life of the lease the estimated depreciated value of such buildings or improvements at the termination of the lease and report as income for each year of the lease an aliquot part thereof.

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 or 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 amount already reported as income on account of the erection of such buildings or improvements. 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 for the year when such destruction takes place the amount previously reported as income

because of the erection of such buildings or improvements, less any salvage value subject to the lease to the extent that such loss was not compensated for 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 for by insurance. See articles 109 and 164.

ART. 49. Compensation for loss.—In the case of property which has been compulsorily or involuntarily converted into cash or its equivalent as a result of (a) its destruction in whole or in part, (b) theft or seizure, or (c) an exercise of the power of requisition or condemnation or the threat or imminence thereof, that amount received by the owner as compensation for the property which is in excess of the cost of the property (or other basis) should be included in gross income. However, the gain to be included in gross income 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. However, if the taxpayer proceeds forthwith in good faith to replace the property as provided in section 214 (a) (12), see articles 261–263.

ART. 50. 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. 51. 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; as to dividends, see

section 201 (e) and articles 1541-1549. 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 March 1, 1913, 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. Such items as claims for compensation under canceled Government contracts constitute income for the year in which they are allowed or their value is otherwise definitely determined.

ART. 52. 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 some future date, the mere crediting on the books of the corporation does not constitute receipt.

ART. 53. Examples of constructive receipt.—When interest coupons have matured and are payable, 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. Defaulted coupons are income for the year in which paid. Dividends on corporate stock are subject to tax when unqualifiedly made subject to the demand of the stockholder. See section 201 of the statute and articles 1541-1549. The distributive share of the profits of a partner in a partnership is regarded as received by him, although not distributed. See section 218 of the statute and articles 331-335. 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. But see section 213(b) (10) and article 89.

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;

(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. In the case of obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit), 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 to the taxpayer from income, war-profits, and excess-profits taxes;

(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 and shall not be construed 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) The income of a nonresident alien or foreign corporation which consists exclusively of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States;

(9) Amounts received as compensation, family allotments and allowances under the provisions of the War Risk Insurance and the Vocational Rehabilitation Acts, or as pensions from the United States for service of the beneficiary or another in the military or naval forces of the United States in time of war;

(10) So much of the amount received by an individual after December 31, 1921, and before January 1, 1927, as dividends or interest from domestic building and loan associations, operated exclusively for the purpose of making loans to members, as does not exceed \$300;

(11) The rental value of a dwelling house and appurtenances thereof furnished to a minister of the gospel as part of his compensation;

(12) The receipts of shipowners' mutual protection and indemnity associations, not organized for profit, and no part of the net earnings of which inures to the benefit of any private stockholder or member, but such corporations shall be subject as other persons to the tax upon their net income from interest, dividends, and rents; * * *.

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. 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—Compensation—War pensions.—(a) Upon the death of an insured the proceeds of his life insurance policies, whether paid to his estate or to any beneficiary (individual, partnership, or corporation), 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 compensa-

tion 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. In addition to this exemption from all Federal taxes, the Revenue Act of 1921 exempts from income tax amounts received as compensation, family allotments, and allowances under the provisions of the War Risk Insurance and the Vocational Rehabilitation Acts, or as pensions from the United States for service of the beneficiary or another in the military or naval forces of the United States in time of war. As to meaning of "military and naval forces of the United States," see section 2 of the statute.

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, 50, 1562, and 1563. 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 generally exempt from tax, in the case of obligations issued by the United States after September 1, 1917, which include Treasury certificates of indebtedness, Treasury notes, Treasury (war) saving certificates, the Liberty bond issues (except the first Liberty loan $3\frac{1}{2}$ per cent bonds and Victory Liberty loan $3\frac{3}{4}$ per cent convertible notes), and Victory Liberty loan $4\frac{3}{4}$ per cent convertible notes, the interest is exempt from tax only if and to the extent provided in the acts authorizing the issues thereof, as amended and supplemented. Treasury notes, Treasury certificates of indebtedness, and Treasury (war) savings certificates have the exemptions described in paragraph (2) of article 83 and all of these certificates (but not the notes) also have the exemptions from surtaxes and profits taxes described in paragraph (3) of article 83. Interest credited to postal savings accounts upon moneys deposited in postal savings banks is exempt from income tax. Interest on the first Liberty loan $3\frac{1}{2}$ per cent bonds and on the Victory Liberty loan $3\frac{3}{4}$ per cent convertible notes, is entirely exempt from Federal, State, and local taxation, except estate or inheritance taxes, but this absolute exemption does not extend to the bonds of the first Liberty loan converted.

ART. 78. Liberty bond exemptions, as amended and supplemented by the Revenue Act of 1921.—The Liberty bond exemptions from surtaxes, war-profits and excess-profits taxes under the Second Liberty Bond Act of September 24, 1917 (as amended by the Third Liberty Bond Act of April 4, 1918, by the supplement to the Second Liberty Bond Act approved September 24, 1918, the Fourth Liberty Bond Act of July 9, 1918), and the Victory Liberty Loan Act of March 3, 1919, have been amended and supplemented by section 1328 of the Revenue Act of 1921. It provides that on and after January 1, 1921, in addition to the exemptions provided in section 7 of the Second Liberty Bond Act and in subdivision (3) of section 1 of the supplement to the Second Liberty Bond Act, but in lieu of the exemptions provided and free from the conditions and limitations imposed in subdivisions (1) and (2) of section 1 of the supplement to the Second Liberty Bond Act and in section 2 of the Victory Liberty Loan Act, the interest on the 4 per cent and 4½ per cent Liberty bonds shall be exempt on an aggregate principal amount of \$125,000 of such bonds until the expiration of two years after July 2, 1921, the date of the termination of the war between the United States and the German Government as fixed by proclamation of the President, and for three years more (from July 3, 1923, to July 2, 1926) on an aggregate principal amount of \$50,000 of such bonds. Since none of the Liberty or Victory issues is subject to normal income tax, and since the Revenue Act of 1921 repeals the excess-profits and war-profits taxes as of January 1, 1922, from that date the question of exemption from such taxes is immaterial and the only important question is the surtax exemption.

Section 1328 of the statute provides:

That the various Acts authorizing the issues of Liberty bonds are amended and supplemented as follows:

(a) On and after January 1, 1921, 4 per centum and 4½ per centum Liberty bonds 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, corporations, or associations, in respect to the interest on aggregate principal amounts thereof as follows:

Until the expiration of two 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, on \$125,000 aggregate principal amount; and for three years more on \$50,000 aggregate principal amount.

(b) The exemptions provided in subdivision (a) shall be in addition to the exemptions provided in section 7 of the Second Liberty Bond Act, and in addition to the exemption provided in subdivision (3) of section 1 of the Supplement to the Second Liberty Bond Act in respect to bonds issued upon conversion of 3½ per centum bonds,

but shall be in lieu of the exemptions provided and free from the conditions and limitations imposed in subdivisions (1) and (2) of section 1 of the Supplement to Second Liberty Bond Act and in section 2 of the Victory Liberty Loan Act.

ART. 79. Liberty bond exemption under Second, Third, and Fourth Liberty Bond Acts—Treasury (war) savings certificates.—Under the Revenue Act of 1921 the exemption provided by section 7 of the Second Liberty Bond Act of September 24, 1917, has not been changed. Section 7 of 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 that in addition to the entire exemption of interest on first Liberty loan $3\frac{1}{2}$ per cent bonds, there shall be exempt from normal income tax all interest on first Liberty loan converted 4 per cent bonds, first Liberty loan converted $4\frac{1}{4}$ per cent bonds, first Liberty loan second converted $4\frac{1}{4}$ 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, Treasury certificates of indebtedness, and Treasury (war) savings certificates. Interest on an aggregate of not exceeding \$5,000 principal amount of bonds included in such later issues, bonds of the first Liberty loan converted, Treasury certificates of indebtedness, and Treasury (war) savings certificates shall be exempt from surtaxes and war-profits and excess-profits taxes, as well as normal tax. Interest in excess of the interest on not exceeding \$5,000 principal amount of such bonds and certificates may, however, be subject to surtaxes and to the war-profits and excess-profits tax and may accordingly be required to be included in gross income.

Treasury (war) savings certificates are issued under the Second Liberty Bond Act and include war savings certificates and Treasury savings certificates. The principal amount of such certificates for the purpose of computing the exemption is their issue price. The difference between the amount paid and the amount received is income to the holder, to be assigned entirely to the year of its receipt if the holder reports on a cash basis, or to be apportioned (on the basis of published redemption prices) to the years of its accrual, if he reports on an accrual basis.

ART. 80. Liberty bond exemption under Supplement to Second Liberty Bond Act, as amended by the Revenue Act of 1921.—The Revenue Act of 1921 in effect repeals subdivisions (1) and (2), but retains subdivision (3), of section 1 of the Supplement to the Second Liberty Bond Act, approved September 24, 1918. Subdivision (3) provides:

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.

This exemption from surtaxes and profits taxes expires July 2, 1923, and is in addition to the exemption provided in section 7 of the Second Liberty Bond Act (see art. 79) 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. 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 4 and $4\frac{1}{4}$ per cent bonds, Treasury certificates of indebtedness, and Treasury (war) savings certificates apportioned as the taxpayer may choose; and also, until the expiration of two years after July 2, 1921 (the date of the termination of the war between the United States and the German Government, as fixed by proclamation of the President), the interest received on not exceeding \$30,000 principal amount of first Liberty loan second converted $4\frac{1}{4}$ per cent bonds (dated Oct. 24, 1918).

ART. 81. Exemptions on Victory notes.—The specific exemptions on notes of the Victory Liberty loan are those prescribed by the Secretary of the Treasury pursuant to the Victory Liberty Bond Act. The Victory Liberty loan $3\frac{3}{4}$ 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 any local taxing authority, except estate or inheritance taxes. The Victory Liberty loan $4\frac{3}{4}$ 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 any local taxing authority, except (a) estate or inheritance taxes, and (b) surtaxes, 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.

ART. 82. Interest accrued upon conversion of Victory notes.—All interest accrued on $4\frac{3}{4}$ per cent Victory notes at the date of any conversion by the taxpayer into $3\frac{3}{4}$ per cent Victory notes shall, for the purpose of computing net income, be deemed to be interest upon $4\frac{3}{4}$ per cent Victory notes, and subject to 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. Any and all amounts received by any taxpayer from the United States by way of adjustment of accrued interest upon the conversion of $4\frac{3}{4}$ per cent Victory notes into $3\frac{3}{4}$ per cent Victory notes shall be deemed to be interest upon $4\frac{3}{4}$ per cent Victory notes.

All interest accrued on $3\frac{3}{4}$ per cent Victory notes at date of any conversion by the taxpayer into $4\frac{1}{4}$ per cent Victory notes shall, for the purpose of computing net income, be deemed to be interest upon $3\frac{3}{4}$ per cent Victory notes and shall be entitled to the exemptions from taxation to which interest on $3\frac{3}{4}$ per cent Victory notes is entitled.

ART. 83. Summary of tax exemptions of Liberty bonds and Victory notes, as amended and supplemented by the Revenue Act of 1921.—Liberty bonds and Victory notes issued under the 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 to the following exemptions on and after January 1, 1921:

(1) $3\frac{1}{2}$ per cent bonds and $3\frac{3}{4}$ per cent notes are exempt from all Federal, State, and local taxation, except estate or inheritance taxes, as follows:

1. First Liberty loan $3\frac{1}{2}$ per cent bonds of 1932-1947—	} 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.
2. Victory Liberty loan $3\frac{3}{4}$ per cent convertible gold notes of 1922-1923—	

(2) 4 per cent and $4\frac{1}{4}$ per cent Liberty bonds and $4\frac{3}{4}$ 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) 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.

(3) 4 per cent and $4\frac{1}{4}$ per cent Liberty bonds (but not $4\frac{3}{4}$ per cent Victory notes), Treasury certificates of indebtedness, and Treasury (war) savings certificates are entitled to certain limited exemptions from surtaxes and excess-profits taxes now or hereafter imposed by the United States. As to $4\frac{3}{4}$ per cent Victory notes, see article 81. For the period from January 1, 1921, to July 2, 1923, the total possible exemption from surtaxes and profits taxes amounts to \$160,000, while for the period from July 3, 1923, to July 2, 1926, the total possible exemption amounts to \$55,000, as follows:

Period Jan. 1, 1921, to July 2, 1923:

\$5,000 in the aggregate of first 4s, first $4\frac{1}{4}$ s, first second $4\frac{1}{4}$ s, second 4s and $4\frac{1}{4}$ s, third $4\frac{1}{4}$ s, fourth $4\frac{1}{4}$ s, Treasury certificates of indebtedness, and Treasury (war) savings certificates.

30,000 of first second $4\frac{1}{4}$ s.

125,000 in the aggregate of first 4s, first $4\frac{1}{4}$ s, first second $4\frac{1}{4}$ s, second 4s and $4\frac{1}{4}$ s, third $4\frac{1}{4}$ s, and fourth $4\frac{1}{4}$ s.

\$160,000 total possible exemptions for this period.

Period July 3, 1923, to July 2, 1926:

\$5,000 in the aggregate of first 4s, first 4½s, first second 4½s, second 4s and 4½s, third 4½s, fourth 4½s, Treasury certificates of indebtedness, and Treasury (war) savings certificates.

50,000 in the aggregate of first 4s, first 4½s, first second 4½s, second 4s and 4½s, third 4½s, and fourth 4½s.

\$55,000 total possible exemptions for this period.

ART. 84. Liberty bond exemption in the case of trusts or partnerships.—(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. 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. As to exemptions in the case of bonds beneficially owned by nonresident aliens, see article 94.

(b) As the 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 he owned such proportionate part of the bonds directly. This principle also applies to stockholders in personal service corporations during the calendar year 1921. See section 218.

ART. 85. Return for fiscal year ending in 1921.—In the case of a return rendered for a fiscal year beginning in 1920 and ending in 1921, the interest received from obligations of the United States issued after September 1, 1917, is, in respect to the amount received prior to January 1, 1921, exempt only if and to the extent provided in the acts authorizing the issue thereof. See article 80, Regulations 45. The interest received on and after January 1, 1921, is exempt in accordance with the acts authorizing the issue thereof as amended and supplemented by section 1328 of the Revenue Act of 1921. See article 83. Since the basis of the exemptions is the principal amount of bonds held rather than the amount of interest received, where the holdings are not constant during the taxable period, if at any time the holdings of any issue or issues are less than the maximum exempted principal, then the exempted interest for such time shall be only the amount of interest received or accrued upon the principal actually held.

ART. 86. 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 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.

ART. 87. 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. 88. Compensation of State officers and employees.—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. Compensation received for services rendered to a State or a political subdivision thereof is included in gross income unless the person receives such compensation as an officer or employee of a State or political subdivision. An officer is a person who occupies a position in the service of the State or political subdivision, the tenure of which is continuous and not temporary and the duties of which are established by law or regulations and not by agreement. An employee is one whose duties consist in the rendition of prescribed services and not the accomplishment of specific objects, and

whose services are continuous, not occasional or temporary. 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 income 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. As to State contracts, see article 37.

ARR. 89. Additional exclusions from gross income under the Revenue Act of 1921.—The following additional exclusions from gross income not provided by the Revenue Act of 1918 are allowed by the Revenue Act of 1921:

(1) Income of a nonresident alien or foreign corporation consisting exclusively of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and corporations organized in the United States. Any taxpayer claiming this exemption must file, under oath, a statement citing the foreign statute which grants the equivalent exemption and stating fully the facts upon which he relies to establish his claim;

(2) So much of the amount received by an individual after December 31, 1921, and before January 1, 1927, as dividends or interest from domestic building and loan associations operated exclusively for the purpose of making loans to members as does not exceed \$300 per year;

(3) Rental value of a dwelling house and appurtenances thereof furnished to a minister of the gospel as part of his compensation;

(4) Receipts of shipowners' mutual protection and indemnity associations not organized for profit and no part of the net earnings of which inures to the benefit of any private stockholder or member. Such associations, however, shall be subject as other taxpayers to the tax upon their net income from interest, dividends, and rents. In other words, they are subject to the taxes imposed by section 230, but only upon net income from interest, dividends, and rents;

(5) Under section 234 (a) (3) any tax paid by a corporation pursuant to a tax-free covenant clause need not be included in the gross income of the bondholder. See article 565.

ART. 90. Income accrued prior to March 1, 1913.—Any claim existing unconditionally on March 1, 1913, 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 to be included in gross income 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. See section 201 of the statute, and articles 1541-1549.

ART. 91. 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 a nonresident alien individual, gross income means only the gross income from sources within the United States, determined under the provisions of section 217.

ART. 92. 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, determined under the provisions of section 217. See articles 316–329. As to the gross income of foreign corporations see section 233 (b) of the statute and article 550; also section 217 and articles 316–329. The items of gross income from sources without the United States and therefore not taxable to nonresident aliens or foreign corporations are described in section 217(c) and article 322. As to who are nonresident alien individuals, see articles 311–314.

ART. 93. 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. 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. See further article 319. 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 311(a).

ART. 94. 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 84.

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; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity; * * *.

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 263. 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, traveling expenses while away from home solely in the pursuit of a trade or business (see article 101 (a)), 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 291–295. As to deductions by corporations see section 234 and articles 561–573.

ART. 101(a). 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 solely on business, the reasonable and necessary traveling expenses, including railroad fares, meals, and lodging, 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 traveling expenses, including the entire amount expended for meals and lodging, 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 the amount so repaid and may deduct such expenses. (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, the amount of the allowance should be included in gross income and the cost of such meals and lodging may be deducted therefrom. A payment for the use of a sample room at a hotel for the display of goods is a business expense. 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 taxable year on account of business; (3) total amount of expenses incident to meals and lodging while absent from home on business during the taxable year; (4) 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.

Commuters' fares are not considered as traveling expenses and are not deductible.

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 deducted in determining the net income for any previous year. If a taxpayer carries incidental materials or supplies on hand for which no record of consumption is kept or of which physical inventories at the beginning and end of the year are not taken, it will be permissible for the taxpayer to include in his expenses and 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 if such account is kept. 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 currently expended for books, furniture, and professional instruments and equipment, the useful life of which is short, may be deducted. See section 215 and articles 291-295.

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 may be in part payment for property. This may occur, for example, where a partnership sells out to a corporation, the former partners agreeing to continue in the service of the corporation. In such a case it may be found that the salaries of the former partners are not merely for services, but in part constitute payment for the transfer of their business.

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

(3) In any event the allowance for the compensation paid may not exceed what is reasonable 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. But if the salaries paid bear a close relationship to stock ownership, see paragraph (1) of this article. 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. 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. It is immaterial whether such bonuses are paid in cash or in kind or partly in cash and partly in kind. Donations made to employees and others, which do not have in them the element of compensation or are in excess of reasonable compensation for services, are considered gratuities and are not deductible from gross income.

ART. 108. Pensions—Compensation for injuries.—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 or accrued as compensation for injuries, are proper deductions as ordinary and necessary expenses. Such deductions are limited to the amount not compensated for by insurance or otherwise. 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 to employees who are absent in the military, naval, or other service of the Government, but who intend to return at the conclusion of such service, 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. 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 auto-

mobile if used wholly in the business of farming is deductible as an expense; if used partly for business purposes and partly for the pleasure or convenience of the taxpayer or his family, such cost may be apportioned according to the extent of the use for purposes of business and pleasure or convenience, and only the proportion of such cost justly attributable to business purposes is deductible as a necessary expense. If a farm is operated for recreation or pleasure and not on a commercial basis, and if the expenses incurred in connection with the farm are in excess of the receipts therefrom, the entire receipts from the sale of products may be ignored in rendering a return of income, and the expenses incurred, being regarded as personal expenses, will not constitute allowable deductions. See 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 51. The expenses, liabilities, or deficit of one year can not be used to reduce the income of a subsequent year. But see section 204 and articles 1601-1605. A taxpayer has the right to deduct all authorized allowances, and it follows that if he does not within any year deduct certain of his expenses, losses, interest, taxes, or other charges, he can not deduct them from the income of the next or any succeeding year. It is recognized, however, that particularly in a going business of any magnitude there are certain overlapping items both of income and deduction, and so long as these overlapping items do not materially distort the income they may be included in the year in which the taxpayer, pursuant to a consistent policy, takes them into his accounts. Judgments or other binding adjudication, such as decisions of referees and boards of review under workmen's compensation laws, on account of damages for patent infringement, personal injuries, or other cause, are deductible from gross income when the claim is so adjudicated or paid, unless taken under other methods of accounting which clearly reflect the correct deduction, 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. A loss from theft or embezzlement occurring in one year and discovered in another is ordinarily

deductible for the year in which sustained. But see article 146. See section 252 of the statute and articles 1031-1038; see also section 214 (a) (6).

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, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title; * * *

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 and first Liberty loan $3\frac{1}{2}$ per cent bonds, the interest upon which is wholly exempt from tax, is not deductible. This exception, however, does not apply in the case of $3\frac{3}{4}$ per cent Victory notes originally subscribed for by the taxpayer, and interest on indebtedness incurred to purchase or carry such notes is deductible. Since other obligations of the United States issued after September 24, 1917, are not wholly exempt from taxation under this title, interest paid on indebtedness incurred or continued to purchase such obligations (whether or not originally subscribed for by the taxpayer) is deductible in accordance with the general rule. 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 but may, under proper circumstances, be deducted as rent.

ART. 122. **Interest on capital.**—Interest calculated for cost-keeping or other purposes on account of capital or surplus invested in the business but which does not represent a charge arising under an interest-bearing obligation, is not an allowable deduction from gross 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 except (a) income, war-profits, and excess-profits taxes imposed by the authority of the United States, (b) so much of the income, war-profits and excess-profits taxes, imposed by the authority of any foreign country or possession of the United States, as is allowed as a credit under section 222, (c) taxes assessed against local benefits of a kind tending

to increase the value of the property assessed, and (d) taxes imposed upon the taxpayer upon his interest as shareholder or member of a corporation, which are paid by the corporation without reimbursement from the taxpayer. For the purpose of this paragraph estate, inheritance, legacy, and succession taxes accrue on the due date thereof except as otherwise provided by the law of the jurisdiction imposing such taxes; * * *

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 381-386 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. 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. Such taxes are deemed to have accrued on the due date thereof, namely, one year after the decedent's death, except in any case where the Commissioner has granted an extension or extensions of time for payment, such taxes are then deemed to have accrued on the due date or dates of such extension or extensions.

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.

ART. 135. Tax on stock.—In computing the net income of an individual no deduction is allowed for the taxes imposed upon his interest as shareholder or member of a bank or other corporation, which are paid by the corporation without reimbursement from the taxpayer. The amount so paid should not be included in the income of the stockholder or member.

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 if and to the extent that the profit, if such transaction had resulted in a profit, would be taxable under this title. No deduction shall be allowed under this paragraph for any loss claimed to have been sustained in any sale or other disposition of shares of stock or securities made after the passage of this Act where it appears that within thirty days before or after the date of such sale or other disposition the taxpayer has acquired (otherwise than by bequest or inheritance) substantially identical property, and the property so acquired is held by the taxpayer for any period after such sale or other disposition. If such acquisition is to the extent of part only of substantially identical property, then only a proportionate part of the loss shall be disallowed;

(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. Losses allowed under paragraphs (4), (5), and (6) of this subdivision shall be deducted as of the taxable year in which sustained unless, in order to clearly reflect the income, the loss should, in the opinion of the Commissioner, be accounted for as of a different period. In case of losses arising from destruction of or damage to property, where the property so destroyed or damaged was acquired before March 1, 1913, the deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913; * * *

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 and allowable as a deduction in computing net income, and the price at which sold or disposed of. See article 1561. 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, or for more than cost but less than the fair market value as of March 1, 1913. See section 202 of the statute and articles 39-46 and 1561. 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, less proper adjustment for depreciation, and the salvage value thereof. In the case of property acquired before March 1, 1913, however, the deductible loss is the difference between the fair market value of the property as of that date, less proper adjustment for depreciation, and the salvage value thereof. In any event the loss should be reduced by the amount of any insurance or other compensation received. See articles 49 and 261-263. 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. 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 depreciation sustained with respect to the property prior to its demolition or scrapping, and allowable as a deduction in computing net income. 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 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, fair market price or value as of that date of any assets so discarded (less any depreciation sustained and allowable as a deduction in computing net income) 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.

ART. 144. Shrinkage in value of stocks.—A person possessing stock of a corporation can not deduct from gross income any amount claimed as a loss merely on account of shrinkage in value of such stock through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the stock is disposed of. See, however, article 154. However, if stock of a corporation becomes worthless, its cost or other basis determined under section 202 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. Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders or general policy of such supervisory officers charge off stock as worthless or write it down to a nominal value, such stock shall, in the absence of affirmative evidence clearly establishing the contrary, be presumed for income tax purposes to be worthless. See article 151. For dealers in securities, see article 1585.

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 sustained and allowable as a deduction in computing net income, 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 sustained and allowable as a deduction in computing net income, 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.

ART. 146. Accounting for losses to reflect income.—As a general rule losses allowed under paragraphs (4), (5), and (6) of this subdivision shall be deducted as of the taxable year in which sustained. In exceptional circumstances, however, in order to avoid injustice to the taxpayer and to more clearly reflect his income, the Commissioner may permit a loss to be accounted for as of a year other than the one in which sustained. For example, an embezzlement or a

shipwreck may occur in 1921 but not become known until 1922 and in such a case income may be more clearly reflected by accounting for the loss as of 1922 rather than of 1921. If a taxpayer desires to account for a loss as of a period other than the one in which actually sustained, he shall attach to his return a statement setting forth his request for consideration of the case by the Commissioner, together with a complete statement of the facts upon which he relies. However, in his income tax return he shall deduct the loss only for the taxable year in which actually sustained. Upon the audit of the return the Commissioner will decide whether the case is within the exception provided by the statute; if not within the exception the loss will be allowed only as of the taxable year in which sustained. The allowance of a deduction for a loss in a year other than the one in which sustained is entirely within the discretion of the Commissioner and he will consider exercising this discretion only in exceptional cases. A shrinkage in the value of the taxpayer's stock in trade, as reflected in his inventory, is not such a loss as is contemplated by the provision of the statute authorizing the Commissioner to allow the deduction of a loss for a taxable year other than the one in which sustained.

ART. 147. Losses from the sale and repurchase of securities.—An individual, other than one in the trade or business of buying and selling securities, or a corporation, other than a dealer in stocks or securities, can not deduct any loss claimed to have been sustained from the sale or other disposition of stock or securities made after November 23, 1921, if within 30 days before or after the date of such sale or other disposition the taxpayer has acquired (otherwise than by bequest or inheritance) substantially identical property, and the property so acquired is held by the taxpayer for any period after such sale or other disposition. If such acquisition is to the extent of part only of substantially identical property, then only a proportionate part of the loss shall be disallowed. See article 1567. This provision is designed to prevent a taxpayer who owns securities, other than one in the trade or business of buying and selling securities, from selling and immediately repurchasing them or from purchasing substantially identical property and immediately selling the original securities and claiming as a deduction in computing net income the so-called "loss" sustained therefrom. Gain or loss, however, is realized in the case of the "short sale." Under this section a taxpayer owning a hundred shares of stock in the X company, who purchases another hundred shares of stock in the X company and within 30 days thereafter sells the first purchased stock of the X company, can not deduct in computing net income any loss claimed to have been sustained from the transaction; if he sells the entire 200 shares of stock, a gain or loss from both transactions is

realized at that time; and if he sells the stock of the X company included within the second purchase a gain or loss is realized thereby.

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 (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt to be charged off in part; * * *

Arr. 151. **Bad debts.**—Bad debts may be treated in either of two ways—(1) by a deduction from income in respect of debts ascertained to be worthless in whole or in part, or (2) by a deduction from income of an addition to a reserve for bad debts. For the year 1921 taxpayers may, regardless of their previous practice, elect either of these two methods and will be required to continue the use in later years of the method so elected unless permission to change to the other method is granted by the Commissioner.

Where all the surrounding and attending circumstances indicate that a debt is worthless, either wholly or in part, the amount which is worthless and charged off or written down to a nominal amount on the books of the taxpayer shall be allowed as a deduction in computing net income. There should accompany the return a statement showing the propriety of any deduction claimed for bad debts. No deduction shall be allowed for the part of a debt ascertained to be worthless and charged off prior to January 1, 1921, unless and until the debt is ascertained to be totally worthless and is finally charged off or is charged down to a nominal amount, or the loss is determined in some other manner by a closed and completed transaction. Before a taxpayer may charge off and deduct a debt in part, he must ascertain and be able to demonstrate, with a reasonable degree of certainty, the amount thereof which is uncollectible. Any amount subsequently received on account of a bad debt or on account of a part of such debt previously charged off, and allowed as a deduction for income tax purposes, must be included in gross income for the taxable year in which received. In determining whether a debt is worthless in whole or in part the Commissioner will consider all pertinent evidence, including the value of the collateral, if any, securing the debt and the financial condition of the debtor. Partial deductions will be allowed with respect to specific debts only.

Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce pay-

ment 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 is generally an indication of the worthlessness of at least a part of an unsecured and unpreferred debt. Actual determination of worthlessness in bankruptcy cases 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 51. 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.

Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders, or in accordance with the general policy of such supervisory officers, charge off debts in whole or in part such debts shall, in the absence of affirmative evidence clearly establishing the contrary, be presumed, for income tax purposes, to be worthless or recoverable only in part, as the case may be.

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. Uncollectible deficiency upon sale of mortgaged or pledged property.—Where mortgaged or pledged property is lawfully sold (whether to the creditor or other purchaser) for less than the amount of the debt, and the mortgagee or pledgee ascertains that

the portion of the indebtedness remaining unsatisfied after such sale is wholly or partially 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 wholly or partially worthless and charged off. Where a taxpayer buys in mortgaged or pledged property for the amount of the debt, no deduction shall be allowed for any part of the debt. Gain or loss is realized when the property bought in is sold or disposed of.

Accrued interest may be included as part of the deduction only when it has previously been returned as income.

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.

A taxpayer (other than a dealer in securities) possessing debts evidenced by bonds or other similar obligations can not deduct from gross income any amount merely on account of market fluctuation. Where a taxpayer ascertains, however, that due, for instance, to the financial condition of the debtor, or conditions other than market fluctuation, he will recover upon maturity none or only a part of the debt evidenced by the bonds or other similar obligations and is able to so demonstrate to the satisfaction of the Commissioner, he may deduct in computing net income the uncollectible part of the debt evidenced by the bonds or other similar obligations.

ART. 155. Reserve for bad debts.—Taxpayers who have, prior to 1921, maintained reserve accounts for bad debts may deduct a reasonable addition to such reserves in lieu of a deduction for specific bad-debt items. Taxpayers who have not heretofore maintained such reserve accounts may now elect to do so, and in such case shall proceed to determine the amount of the reserve that should reasonably have been set up as at December 31, 1920 (which shall not be deducted in computing net income), and in respect of 1921 and subsequent years may add a reasonable addition to such reserve and deduct the amount in computing taxable net income. Where a reserve account is maintained, debts ascertained after December 31, 1920, to be worth-

less in whole or in part, (a) if such debts were outstanding at December 31, 1920, should be charged against the reserve and may be deducted from income, in accordance with article 151; (b) if such debts arose after December 31, 1920, should be charged against the reserve, and not deducted from income. What constitutes a reasonable addition to a reserve for bad debts must be determined in the light of the facts, and will vary as between classes of business and with conditions of business prosperity. A taxpayer using the reserve method should make a statement in his return showing the volume of his charge sales (or other business transactions) for the year and the percentage of the reserve to such amount, the total amount of notes and accounts receivable at the beginning and close of the taxable year, and the amount of the debts which have been ascertained to be wholly or partially worthless and charged against the reserve account during the taxable year.

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. In the case of such property acquired before March 1, 1913, this deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913; * * *

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 reasonably consistent plan (not necessarily at a uniform rate) by which the aggregate of such amounts for the useful life of the property in the business will suffice, with the salvage value, and having due regard for expenditures made for current upkeep, at the end of such useful life to provide in place of the property its original cost (not replacement 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 provisions 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 original 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 must have due regard to operating conditions during the taxable period. While the burden of proof must rest upon the taxpayer to sustain the deduction taken by him, such deductions must not be disallowed unless shown by clear and convincing evidence to be unreasonable. The reasonableness of any claim for depreciation shall be determined upon the conditions known to exist at the end of the period for which the return is made.

ART. 166. Modification of method of computing depreciation.—If it develops that an error was made in estimating the useful life of the property, 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 the 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 (not past) 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 141-146.

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 war against the German Government, 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 such war, there shall be allowed, for any taxable year ending before March 3, 1924 (if claim therefor was made at the time of filing return for the taxable year 1918, 1919, 1920, or 1921) 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 Act of Congress as a deduction in computing net income. At any time before March 3, 1924, 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 income, war-profits, and excess-profits taxes 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.—An allowance for amortization may be deducted only in returns filed for taxable years ending on or before February 29, 1924. Such allowance with respect to any period of time subsequent to December 31, 1920, may be deducted only if a claim for amortization (unmistakably differentiated from all other claims for wear, tear, obsolescence, and loss) was made at the time of filing the return for the taxable year 1918, 1919, 1920 or 1921.

All allowances made to a taxpayer by a contracting department of the Government, or by any other contractor, for amortization specifically as such, shall be treated as a reduction of the cost of the taxpayer's plant investment. Further amortization is allowable only in respect of such reduced cost. Where no such allowance has been made 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 amount 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 article 186. Depreciation will be allowed, beginning at the close of the amortiza-

tion period, upon property the cost of which has been partly amortized but shall be limited to 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 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 war against the German Government, and of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of such war.

The allowance may be deducted only by taxpayers who after April 6, 1917, have constructed or otherwise acquired plant or other facilities for the actual production of articles contributing to the prosecution of the war. It is not sufficient, to entitle the taxpayer to the allowance, that the nature of his business is such as to contribute to the production of articles. For example, a taxpayer, such as a railroad, whose business activities are confined to transportation (other than water transportation) is not entitled to the allowance. A taxpayer, the nature of whose business is the actual production of articles, however, may claim the allowance with respect to the cost of all buildings, machinery, equipment or other facilities which were constructed for use or which were used in connection with the production of such articles, both in the acquisition and transportation of raw material, the actual process of manufacture or other conversion, and the transportation and marketing of the finished product.

In the case of facilities 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 (or should have been) properly entered on the books of the taxpayer on or after that date.

ART. 184. Computation of amortization allowance.—The total amount of the amortization allowance is 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 which has been sold or permanently discarded, or which will be sold or permanently discarded before

March 3, 1924, 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 plus a reasonable allowance for depreciation in case the property is used in the taxpayer's business after the close of the amortization period. Such fair market value shall be established by investigation of engineers of the Bureau of Internal Revenue, if such investigation is deemed advisable.

(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 and not greater than the estimated cost of replacement under normal postwar conditions less depreciation and depletion. Upon the basis of the costs prevailing at the latest prewar date at which a reasonably normal market existed, the Commissioner shall in respect of basic material and labor costs determine and publish ratios of estimated postwar costs of replacement, and a taxpayer shall use such ratios in computing a claim for a tentative allowance for amortization. Such tentative allowance may be redetermined on or before March 3, 1924, at the request of the taxpayer or by the Commissioner.

Special record of all property falling in (1) above, must be preserved by the taxpayer, and the Commissioner must be notified with the next tax return (*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.

Arr. 185. Amortization period.—The amortization allowance shall be apportioned (*a*) in cases where the property was employed in the production of articles contributing to the prosecution of the war, over the respective accounting periods of the taxpayer, having reasonable regard to his gross and net income, and where separately ascertainable the income from the facilities upon which amortization is claimed, between January 1, 1918 (or if the property was acquired subsequent to that date, January 1 of the year in which acquired), and the actual or estimated date of cessation of operations as a war facility, and (*b*) in cases where the property was not completed in time for use in the production of articles contributing to the prosecution of the war, on the basis of the expenditures made on account of which amortization is allowed.

All taxpayers claiming an allowance for amortization shall compute the amount of their claims applicable to each accounting period between January 1, 1918, to the date specified above. Taxpayers reporting on the fiscal year basis shall (*a*) in all computations based upon 1918 rates for 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; (c) in all computations for a year beginning in 1919 and ending in 1920, 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; (d) in all computations based upon 1920 rates for a year beginning in 1920 and ending in 1921, use the amount of such allowance apportioned to the calendar year 1920; (e) in all computations based upon 1921 rates for years ending in 1921 or 1922, use the amount of such allowance apportioned to the calendar year 1921; (f) in all computations based upon 1922 rates for a year beginning in 1921 and ending in 1922, use the amount of such allowance apportioned to the calendar year 1922; (g) and 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 in 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. 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 before March 3, 1924, 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 March 3, 1924, 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: *And provided further*, That such depletion allowance based on discovery value shall not exceed the net income, computed without allowance for depletion, from the property upon which the discovery is made, except where such net income so computed is less than the depletion allowance based on cost or fair market value as of March 1, 1913; 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. These paragraphs of the statute are not materially different from the corresponding paragraphs of the Revenue Act of 1918. These provisions of the statute and articles 201-237 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) the cost of his property if acquired subsequent to March 1, 1913, or (b) the value of his property on the basic date, plus subsequent allowable capital additions (see art. 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 (201-237) 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.

(c) A "mineral property" or "property" is the mineral deposit, the development and plant necessary for its extraction, and so much of the surface as is reasonably expected to be underlaid with the mineral. 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, and to the "oil and gas" in the case of a well producing both oil and gas. 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" include 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.

(g) "Depletion or depreciation sustained": (1) In arriving at the amount returnable through depletion or depreciation, means (except in cases where a discovery has been established, as to which, see (h) below), depletion or depreciation actually sustained based on

the value as at the basic date; (2) in arriving at profit or loss from sale, means depletion or depreciation allowed based on value as at basic date except where value as at basic date is a discovery value, in which case the depletion sustained is that based on value as of March 1, 1913, or cost if acquired after that date; (3) in arriving at invested capital, means depletion and depreciation actually sustained based on cost.

(*h*) Depletion allowance in case of discovery: The deduction for depletion in case of a discovery can not exceed the net income computed without allowance for depletion, from the property upon which the discovery is made, except where and to the extent that such net income so computed is less than the depletion allowance based on cost or fair market value as of March 1, 1913. Net income is the gross income from the sale of all mineral products and any other income incidental to the operation of the property for the production of the mineral products, less operating expenses, including depreciation on equipment, and taxes, but excluding any allowance for depletion. If the mineral products are not sold as raw material but are manufactured or converted into a refined product, then the gross income shall be assumed to be equivalent to the market or field price of the raw material before conversion. Operating expenses, depreciation, and taxes on the property upon which the discovery is made, should be applied against the gross income from the same property on the basis of actual expenditures, but if the records for the year 1921 are in any case inadequate, allocation of such expenditures for that year may be made on the basis of the ratio of (1) the number of wells operated on the property on which the discovery is made to (2) the total number of wells operated in the operating division in which the discovery is included.

ART. 202. Amount returnable through depletion and depreciation deductions in the case of an operating owner.—In the case of an operating owner in fee, the amount remaining in any year returnable 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 and the residual value of other property at the end of operations. The amount returnable through depletion is the total capital remaining less the sum recoverable through depreciation.

ART. 203. Amount returnable through depletion and depreciation deductions in the case of lessee.—(*a*) In the case of a lessee, the amount remaining in any year returnable 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 and the residual value of other property at the end of operations. The amount returnable 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. Amount returnable through depletion and depreciation in case of lessor.—(a) In the case of a lessor, the amount remaining in any year returnable 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 and the residual value of other property at the end of operations. The amount returnable 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 other than oil and gas.—(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 and, in the absence of better evidence, disinterested appraisals by approved methods. Valuations by analytic appraisal methods, such as the

present value method, are not entitled to great weight: (1) If the value of a mineral deposit can be determined upon the basis of cost or replacement value, (2) if the knowledge of the presence of the mineral has not greatly enhanced the value of the mineral property, (3) if the removal of the mineral does not materially reduce the value of the property from which it is taken, or (4) if the profits arising from the exploitation of the mineral deposit are wholly or in great part due to the manufacturing or marketing ability of the taxpayer, or to extrinsic causes other than the possession of the mineral itself. Where the fair market value must be ascertained as of a certain date, analytic appraisal methods will not be used if the fair market value can reasonably be determined by any other method.

(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 mineral 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, and (6) the rate of interest 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 shall be determined in accordance with article 208. 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 includes all current expense of producing, preparing, and marketing the mineral product sold (due consideration being given to taxes) exclusive of 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 number of units of mineral recoverable in marketable form multiplied by the difference between the selling price and the operating cost per unit gives 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. The degree of risk is generally lowest in cases where the factors of valuation are fully supported by the operating record of the mineral property prior to the basic date; relatively higher risks attach to appraisals upon any other basis.

ART. 206(A). Determination of fair market value of oil and gas properties.—(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 oil and gas 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, and, in the absence of better evidence, disinterested appraisals by approved methods. Where the fair market value must be ascertained as of a certain date, analytic appraisal methods, such as the present value method, will not be used if the fair market value can reasonably be determined by any other method.

(b) To determine the fair market value of an oil and/or gas 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 oil and gas in terms of the principal or customary unit (or units) paid for in the product marketed; (2) the average quality or grade of the oil and gas reserves; (3) the expected percentage of extraction or recovery in each process or operation necessary for the preparation of the oil and gas 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; and (6) the rate of interest 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 oil and gas, percentage of recovery, costs of production, interest rate, and selling price of the product marketed during the expected operating life of the oil and gas deposit.

(c) Oil and gas 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 oil and gas deposits in the property itself, the rate at which additional oil and gas has been disclosed by exploitation, the stage of operating life of the property, and any other evidence tending to establish a reasonable estimate of the required factors.

(d) The oil content in the case of oil wells shall be determined in accordance with article 209, and the gas content in the case of gas

wells in accordance with articles 211 and 212. The rate of exhaustion of a mineral deposit should be determined by the character of the deposit, by the ability to market the oil and/or gas deposit, by labor conditions, and by the operating program in force or definitely adopted at the basic date for future operations. The operating life of an oil and/or gas property is that number of years necessary for the expansion of the property at the rate determined by the actual or estimated rate of decline. The operating cost includes all current expense of producing, preparing, and marketing the oil and/or gas produced (due consideration being given to taxes), exclusive of allowable capital additions as defined in article 222 and deductions for depreciation and depletion, but including cost of repairs and replacement necessary to maintain the plant and equipment. This cost of repairs and replacement is not to be confused with the depreciation deduction by which the cost or value of plant and equipment is returnable 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 number of units of mineral recoverable in marketable form multiplied by the difference between the selling price and the operating cost per unit gives 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. The degree of risk is generally lowest in cases where the factors of valuation are fully supported by the operating record of the oil and/or gas property prior to the basic date; relatively higher risks attach to appraisals upon any other basis.

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 or of misrepresentation or fraud or gross error as to any facts determinable on the basic date. Revaluation on account of misrepresentation or fraud or such gross error will only be made upon written application to the Commissioner and approval thereof by him. 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 ac-

cordance 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 (acres, 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 information subsequently obtained clearly shows the estimate to have been materially erroneous, it may be revised with the approval of the Commissioner.

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 sustained for the taxable year shall be computed 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 or produced within the taxable year. The depletion deduction for the taxable year is subject, however, to the limitation contained in article 201 (h). 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 deduction 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 sustained for the taxable year. The depletion deduction for the taxable year is subject, however, to the limitation contained in article 201 (h).

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 10 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.—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 and/or gas for each property is the quotient obtained by dividing the amount returnable through depletion for each property by the estimated number of units of recoverable oil and/or gas on that property. This unit for each separate property multiplied by the number of units of oil and/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, sub-

ject, however, to the limitation contained in article 201(*h*). The total allowance for depletion of all the oil and/or gas properties of the taxpayer will be the sum of the amounts computed for each property separately: *Provided*, That in the case of gas properties the depletion sustained for each pool may be computed by using the total amount 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 amount remaining to be recovered through depletion by the lessor at the date of lease. If the bonus exceeds the amount 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 amount remaining to be recovered by the lessor through depletion, the difference may be recovered through depletion deductions based on the royalties thereafter received to the extent that such deductions are legally allowable. 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 the amount returnable 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.

Arr. 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.

Arr. 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 and in case of discovery

the net income from the property upon which the discovery was made; (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.

(c) All statements required to be furnished in connection with the returns of taxpayers claiming depletion or depreciation must be under oath and may be included in a single affidavit.

ART. 218. Additional statement to be attached to return where depletion of oil or gas is 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 subsequent 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 and/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 and/or gas in the property at the time the value or cost was determined); (f) the quantity of oil and/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) and in case of discovery the net income from the property upon which the discovery was made; (g) the number of acres of producing and proven oil and/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*) 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 (*g*) *infra*.

(*b*) 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 disproportion-

ate 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.

(c) 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.

(d) 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.

(e) 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.

(f) 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.

(g) 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.

ARR. 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/or 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 sections 214(a)(10) and 234(a)(9) of the Revenue Act of 1921, 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 and/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 unless the tract or lease had been acquired before it became so proven. 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 begun, 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 net receipts from minerals sold shall be charged to capital account recoverable through depletion, while the mine is in the development stage. Expenditures made in order to maintain the mine at its normal output shall be deducted as an expense in the year in which the expenditure is made or accrues. Any expenditure for extraordinary development and equipment, such as stripping, shaft sinking, tunneling, and other work beyond that necessary to maintain the mine at its normal production or output, should be carried forward and apportioned and deducted as an 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. See articles 103, 293, and 582.

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 a development 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 a development 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 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 in accordance with article 1582. 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, including 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 art. 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 depreciated value remaining 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 and/or gas properties will, in addition to and apart from the deduction allowable for depletion 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, if acquired prior to that date), 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 im-

provements 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 (see arts. 103, 293, and 582), 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 material 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.

ARR. 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 articles 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 article 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 depreciation and depletion 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 or for the use of: (A) The United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes; (B) any corporation, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including posts of the American Legion or the women's auxiliary units thereof, 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 (C) the special fund for vocational rehabilitation authorized by section 7 of the Vocational Rehabilitation Act; to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this paragraph. In case of a nonresident alien individual this deduction shall be allowed only as to contributions or gifts made to domestic corporations, or to community chests, funds, or foundations, created in the United States, or to such vocational rehabilitation fund. 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; * * *

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 to or for the use of: (a) The United States, the District of Columbia, or any State or Territory or political subdivision thereof, for exclusively public purposes; (b) any corporation or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual; or (c) the special fund for vocational rehabilitation under the Vocational Rehabilitation Act of June 27, 1918. For a discussion of what corporations and organizations are included within (b) see article 517. Deduction of contributions to posts of the American Legion or the women's auxiliary units thereof is expressly allowed by the statute.

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 of depreciation sustained and

allowable as a deduction in computing net income. A gift of real estate to a city to be maintained perpetually as a public park is an allowable deduction under the present statute, but was not an allowable deduction under the Revenue Act of 1918. The proportionate share of contributions made by a partnership 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; but 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. See article 331. This article does not apply to gifts by estates and trusts or corporations. See section 219 of the statute and articles 561 and 562.

INVOLUNTARY CONVERSION OF PROPERTY.

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

(12) If property is compulsorily or involuntarily converted into cash or its equivalent as a result of (A) its destruction in whole or in part, (B) theft or seizure, or (C) an exercise of the power of requisition or condemnation, or the threat or imminence thereof; and if the taxpayer proceeds forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, to expend the proceeds of such conversion in the acquisition of other property of a character similar or related in service or use to the property so converted, or in the acquisition of 80 per centum or more of the stock or shares of a corporation owning such other property, or in the establishment of a replacement fund, then there shall be allowed as a deduction such portion of the gain derived as the portion of the proceeds so expended bears to the entire proceeds. The provisions of this paragraph prescribing the conditions under which a deduction may be taken in respect of the proceeds or gains derived from the compulsory or involuntary conversion of property into cash or its equivalent, shall apply so far as may be practicable to the exemption or exclusion of such proceeds or gains from gross income under prior income, war-profits, and excess-profits tax acts; * * *

ART. 261. Involuntary conversion of property.—Sections 214(a) (12) and 234(a) (14) of the statute deal with cases where property is compulsorily or involuntarily converted into cash or its equivalent as a result of fire, shipwreck, theft, condemnation or similar causes enumerated in the statute. Under regulations prescribed by the Commissioner with the approval of the Secretary, the taxpayer is permitted to deduct gains which may be thus involuntarily realized (through insurance or otherwise) when he proceeds forthwith in good faith to expend the proceeds of such conversion (1) in the acquisition of other property of a character similar or related in

service or use to the property so converted, (2) in the acquisition of 80 per cent or more of the stock or shares of a corporation owning such other property, or (3) in the establishment of a replacement fund. When only part of the proceeds of such conversion is thus expended (for example, one-third) a corresponding part of the gain (in the example given, one-third) may be deducted. The statute also provides that for the purpose of determining gain or loss the property acquired takes the place of a like proportion of the property converted (in the example given, one-third). See section 202(d)(2) and article 1567. The new or restored property, to the extent of the replacement, shall not be valued in the accounts of the taxpayer at an amount in excess of the cost of the old property (or of its value as of March 1, 1913, if acquired before that date and such value is higher than the cost) after making proper provision in either case for depreciation of the original property, plus the cost of any actual additions and betterments.

This provision relating to the involuntary conversion of property applies, so far as may be practicable, to the exemption or exclusion of the proceeds thereof or the gains derived therefrom from gross income under prior income, war-profits, and excess-profits tax acts. Articles 261, 262, and 263 have no application to property which is voluntarily sold or disposed of. As to replacement funds, see article 263.

ART. 262. Ascertainment of gain.—In cases of involuntary conversion of property within the provisions of sections 214(a)(12) or 234(a)(14), the gain must be included in income and no deduction will be allowed unless the taxpayer proceeds forthwith in good faith to expend the proceeds of such conversion in any of the three ways described in article 261. If the taxpayer does not elect so to expend the proceeds of the conversion, the gain, if any, shall be ascertained as provided in article 49.

ART. 263. Replacement funds.—In any case where the taxpayer elects to replace or restore the converted 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 part or all of the compensation so received shall be held, without deduction for the payment of any mortgage, and pending the disposition thereof the deduction shall be tentatively allowed. 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 1329 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.

DEDUCTIONS ALLOWED: NONRESIDENT ALIEN INDIVIDUAL.

[Sec. 214.] (b) In the case of a nonresident alien individual, the deductions allowed in subdivision (a), except those allowed in paragraphs (5), (6), and (11), shall be allowed only if and to the extent that they are connected with income from sources 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 as provided in section 217 under rules and regulations prescribed by the Commissioner with the approval of the Secretary. In the case of a citizen entitled to the benefits of section 262 the deductions shall be the same and shall be determined in the same manner as in the case of a nonresident alien individual.

ART. 271. Deductions allowed nonresident alien individuals.—In the case of a nonresident alien individual the deductions allowed by section 214(a) for business expenses, interest, taxes, losses in trade, bad debts, depreciation, amortization, depletion, and involuntary conversion of property, are allowed only if and to the extent that they are connected with income from sources within the United States. See section 217 and article 329. As to deductions for losses not connected with the trade or business allowed by paragraphs (5) and (6) of section 214(a) and contributions (par. 11), see article 324. As to deductions allowed foreign corporations, see section 234(b) of the statute and article 573.

ITEMS NOT DEDUCTIBLE.

Sec. 215. (a) That in computing net income no deduction shall in any case be allowed in respect of—

- (1) Personal, living, or family expenses;
- (2) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;
- (3) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made; or

(4) 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.

(b) Amounts paid under the laws of any State, Territory, District of Columbia, possession of the United States, or foreign country as income to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall not be reduced or diminished by any deduction for shrinkage (by whatever name called) in the value of such interest due to the lapse of time, nor by any deduction allowed by this Act for the purpose of computing the net income of an estate or trust but not allowed under the laws of such State, Territory, District of Columbia, possession of the United States, or foreign country for the purpose of computing the income to which such holder is entitled.

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. Where the father is legally entitled to the services of his minor children, any 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 (including amounts expended for meals and lodging) while away from home in the pursuit of a trade or business are deductible under the Revenue Act of 1921. See further article 101(a).

ART. 293. Capital expenditures.—Amounts paid for increasing the capital value or for making good the depreciation (for which a deduction has been made) 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 ordinarily not deductible but, subject to the provisions of the statute, may in certain cases represent a loss. 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 105-108. In either case the proceeds of such policies paid upon the death of the insured may be excluded from gross income whether the beneficiary is an individual or a corporation. See section 213(b)(1) and articles 72 and 541.

ART. 295. Life or terminable interests.—Amounts paid to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall not be subject to any deduction for shrinkage (whether called depreciation or any other name) in the value of such interest due to the lapse of time. In other words, the holder of such an interest so acquired may not set up the value of the expected future payments as corpus or principal and claim deductions for shrinkage or exhaustion thereof due to the passage of time.

No deduction shall be allowed in the case of a life or terminable interest acquired by gift, bequest, or inheritance, where the estate or trust is entitled to a deduction under the statute but there is no reduction of the income of the life or terminable interest. For example, an estate or a trust in a certain State sells securities at a loss; if, under the laws of that State, the beneficiary suffers no actual loss, then even though the estate or trust is permitted to deduct such loss in making its return, the beneficiary whose income has not been diminished thereby is not entitled to a deduction on account of such

loss but must include in his return the full amount distributed or distributable. See article 347.

CREDITS ALLOWED INDIVIDUALS.

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

(a) The amount received as dividends (1) from a domestic corporation other than a corporation entitled to the benefits of section 262, or (2) from a foreign corporation when it is shown to the satisfaction of the Commissioner that more than 50 per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the provisions of section 217;

(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 \$2,500, unless the net income is in excess of \$5,000, in which case the personal exemption shall be \$2,000. A husband and wife living together shall receive but one personal exemption. The amount of such personal exemption shall be \$2,500, unless the aggregate net income of such husband and wife is in excess of \$5,000, in which case the amount of such personal exemption shall be \$2,000. If such husband and wife make separate returns, the personal exemption may be taken by either or divided between them. In no case shall the reduction of the personal exemption from \$2,500 to \$2,000 operate to increase the tax, which would be payable if the exemption were \$2,500, by more than the amount of the net income in excess of \$5,000;

(d) \$400 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 or of a citizen entitled to the benefits of section 262, the personal exemption shall be only \$1,000, and he shall not be entitled to the credit provided in subdivision (d);

(f) The credits allowed by subdivisions (c), (d), and (e) of this section shall be determined by the status of the taxpayer on the last day of the period for which the return of income is made; but in the case of an individual who dies during the taxable year, such credits shall be determined by his status at the time of his death, and in such case full credits shall be allowed to the surviving spouse, if any, according to his or her status at the close of the period for which such survivor makes return of income.

ART. 301. Credits against net income.—(a) 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 sec. 201 and arts. 1541-1549) received from a domestic corporation other than a corporation entitled to the benefits of section 262, or (2) from a foreign corporation when it is shown to the satisfaction of the Commissioner that more than 50 per cent of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the provisions of section 217 (see art. 318); interest not entirely exempt from tax (and hence included in gross income) 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 the dividends just described nor to interest on any obligations of the United States. See section 213 (b) of the statute and articles 77-84 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.

(b) Under the Revenue Act of 1921 a single person is entitled to a personal exemption of \$1,000 regardless of the amount of his net income, but the personal exemption of a head of a family or of a married person living with husband or wife is \$2,500, unless the net income is in excess of \$5,000, in which event the personal exemption is \$2,000. A husband and wife living together have but one personal exemption, the amount of which depends upon whether their combined net income is in excess of \$5,000. If they make separate returns, such exemption may be taken by either or divided between them. To prevent a slight increase above \$5,000 in net income from causing a disproportionate increase in tax, section 216(c) provides that in no case shall the reduction of the personal exemption from \$2,500 to \$2,000 operate to increase the tax which would be payable if the exemption were \$2,500, by more than the amount of the net income in excess of \$5,000. For example, a married man with no dependents, having a net income of \$5,005, would pay without the benefit of this provision a normal tax of \$120.20 (\$5,005 less \$2,000, or \$3,005, at 4 per cent), but under this provision his normal tax is only \$105.20 (\$5,005 less \$2,500, or \$2,505, at 4 per cent, or \$100.20, plus \$5, the amount by which his net income exceeds \$5,000). The only incomes affected by this equalizing provision are those in excess of \$5,000 but not in excess of \$5,019.99.

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. As to the amount of the exemption see article 301.

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 \$400 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 or \$2,500, as the case may be, 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 \$400 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, 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 sections 219 (c) and 226 (c) of the statute and articles 346, 421, and 431. 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 citizen entitled to benefits of section 262 and non-resident alien individual.—A citizen entitled to benefits of section 262 and a nonresident alien individual, similarly to a citizen or resident, are entitled for the purpose of the normal tax to the dividend credit described in article 301. They are also entitled in every case to a personal exemption of \$1,000, but under no circumstances to any credit for dependents. Under the Revenue Act of 1921, the provisions of tax laws of the foreign country of which a nonresident is a citizen or subject are immaterial, the right to a personal exemption of \$1,000 being absolute.

NET INCOME OF NONRESIDENT ALIEN INDIVIDUALS.

SEC. 217. (a) That in the case of a nonresident alien individual or of a citizen entitled to the benefits of section 262, the following items of gross income shall be treated as income from sources within the United States:

(1) Interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, not including (A) interest on deposits with persons carrying on the banking business paid to persons not engaged in business within the United States and not having an office or place of business therein, or (B) interest received from a resident alien individual or a resident foreign corporation when it is shown to the satisfaction of the Commissioner that less than 20 per centum of the gross income of such resident payor has been derived from sources

within the United States, as determined under the provisions of this section, for the three-year period ending with the close of the taxable year of such payor, or for such part of such period immediately preceding the close of such taxable year as may be applicable;

(2) The amount received as dividends (A) from a domestic corporation other than a corporation entitled to the benefits of section 262, or (B) from a foreign corporation unless less than 50 per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the provisions of this section;

(3) Compensation for labor or personal services performed in the United States;

(4) Rentals or royalties from property located in the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using in the United States, patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property; and

(5) Gains, profits, and income from the sale of real property located in the United States.

(b) From the items of gross income specified in subdivision (a) there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as net income from sources within the United States.

(c) The following items of gross income shall be treated as income from sources without the United States:

(1) Interest other than that derived from sources within the United States as provided in paragraph (1) of subdivision (a);

(2) Dividends other than those derived from sources within the United States as provided in paragraph (2) of subdivision (a);

(3) Compensation for labor or personal service performed without the United States;

(4) Rentals or royalties from property located without the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using without the United States, patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property; and

(5) Gains, profits, and income from the sale of real property located without the United States;

(d) From the items of gross income specified in subdivision (c) there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto, and a ratable part of any expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income. The remainder, if any, shall be treated in full as net income from sources without the United States.

(e) Items of gross income, expenses, losses and deductions, other than those specified in subdivisions (a) and (c), shall be allocated or apportioned to sources within or without the United States under rules and regulations prescribed by the Commissioner with the approval of the Secretary. Where items of gross income are sep-

arately allocated to sources within the United States, there shall be deducted (for the purpose of computing the net income therefrom) the expenses, losses and other deductions properly apportioned or allocated thereto and a ratable part of other expenses, losses or other deductions which can not definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as net income from sources within the United States. In the case of gross income derived from sources partly within and partly without the United States, the net income may first be computed by deducting the expenses, losses or other deductions apportioned or allocated thereto and a ratable part of any expenses, losses or other deductions which can not definitely be allocated to some item or class of gross income; and the portion of such net income attributable to sources within the United States may be determined by processes or formulas of general apportionment prescribed by the Commissioner with the approval of the Secretary. Gains, profits and income from (1) transportation or other services rendered partly within and partly without the United States, or (2) from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States, or produced (in whole or in part) by the taxpayer without and sold within the United States, shall be treated as derived partly from sources within and partly from sources without the United States. Gains, profits and income derived from the purchase of personal property within and its sale without the United States or from the purchase of personal property without and its sale within the United States, shall be treated as derived entirely from the country in which sold.

(f) As used in this section the words "sale" or "sold" include "exchange" or "exchanged"; and the word "produced" includes "created," "fabricated," "manufactured," "extracted," "processed," "cured," or "aged."

(g) A nonresident alien individual or a citizen entitled to the benefits of section 262 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 in 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 credit allowed in subdivision (e) of section 216 may, in the discretion of the Commissioner, 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 or foreign trader shall be liable to distraint for the tax.

ART. 311. Definition.—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 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. A foreign corporation is one incorporated under the laws of a foreign country. As to when a citizen or domestic corporation is entitled to the benefits of section 262, see articles 1135-1137. For the treatment of foreign life insurance companies, see section 245(c) and article 687.

ART. 311(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, 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 93.

ART. 312. 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 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 credible 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.

ART. 313. 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 article 305.

ART. 314. Duty of employer to determine status of alien employee.—If wages are paid to aliens without withholding the tax, except as permitted in article 315, the employer should be prepared to prove the status of the alien as provided in the foregoing articles. An em-

ployer 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 need not secure Form 1078 from the alien if he is satisfied that the alien is a resident alien. 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 competent evidence. The written statement of the alien employee may ordinarily be relied upon by the employer as proof that the alien is a resident of the United States.

ART. 315. Allowance of personal exemption to nonresident alien employee.—A nonresident alien employee may claim the benefit of the credit for personal exemption by filing with his employer Form 1115 duly filled out and executed under oath. 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, 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 361-375.

ART. 316. Income from sources within the United States.—Nonresident alien individuals, foreign corporations, and citizens of the United States or domestic corporations entitled to the benefits of section 262 are taxable only upon income from sources within the United States. See sections 213(c), 233(b), and 262.

The statute divides the income of such taxpayers into three classes: (1) Income which is derived in full from sources within the United States; (2) income which is derived in full from sources without the United States; and (3) income which is derived partly from sources within and partly from sources without the United

States. The taxable income includes that derived in full from sources within the United States and that portion of the income which is derived partly from sources within and partly from sources without the United States which is allocated or apportioned to sources within the United States.

ART. 317. Interest.—There shall be included in the gross income from sources within the United States, of nonresident alien individuals, foreign corporations and citizens of the United States or domestic corporations which are entitled to the benefits of section 262, all interest received or accrued, as the case may be, on bonds, notes, or other interest-bearing obligations of residents of the United States, whether corporate or otherwise, except:

(a) Interest paid on deposits with persons, including individuals, partnerships, or corporations carrying on the banking business, to persons (nonresident alien individuals, foreign corporations and citizens of the United States, or domestic corporations entitled to the benefits of sec. 262) not engaged in business within the United States, and not having an office or place of business therein; and

(b) Interest received from a resident alien individual or a resident foreign corporation when it is shown to the satisfaction of the Commissioner that less than 20 per cent of the gross income of such resident payor has been derived from sources within the United States for the three-year period ending with the close of the taxable year of such payor, or for such part of such period immediately preceding the close of such taxable year as may be applicable.

Any taxpayer who excludes from gross income from sources within the United States income of the type specified in (a) or (b) above shall file with his return a statement setting forth the amount of such income and such information as may be necessary to show that the income is of the type specified in those paragraphs.

ART. 318. Dividends.—Gross income from sources within the United States includes all dividends, as defined by section 201:

(a) From a domestic corporation other than one entitled to the benefits of section 262; and

(b) From a foreign corporation unless less than 50 per cent of its gross income for the three-year period ending with the close of its taxable year preceding the declaration of such dividends or for such part of such period as it has been in existence, was derived from sources within the United States.

Dividends will be treated as income from sources within the United States unless the taxpayer submits sufficient data to establish the fact that less than 50 per cent of the gross income of the foreign payor corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividend was derived from sources within the United States.

ART. 319. Compensation for labor or personal services.—Gross income from sources within the United States includes compensation for labor or personal services performed within the United States regardless of the residence of the payor, of the place in which the contract for services was made, or of the place of payment. When a specific amount is paid for labor or personal services performed in the United States, such amount shall be included in the gross income. When no accurate allocation or segregation of compensation for labor or personal services performed in the United States can be made, or when such labor or service is performed partly within and partly without the United States, the amount to be included in the gross income shall be determined by an apportionment on the time basis, i. e., there shall be included in the gross income an amount which bears the same relation to the total compensation as the number of days of performance of the labor or services within the United States bears to the total number of days of performance of labor or services for which the payment is made.

ART. 320. Rentals and royalties.—Gross income from sources within the United States includes rentals or royalties from property located within the United States or from any interest in such property, including rentals or royalties for the use of or the privilege of using, in the United States, patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property. The income arising from the rental of property, whether tangible or intangible, located within the United States, or from the use of property, whether tangible or intangible, within the United States, is from sources within the United States.

ART. 321. Sale of real property.—Gross income from sources within the United States includes gain, computed under the provisions of section 202, derived from the sale or other disposition of real property located in the United States. For the treatment of capital net gain, see section 206 and articles 1651–1653.

ART. 322. Income from sources without the United States.—Gross income from sources without the United States includes:

(1) Interest other than that specified in section 217(a)(1), and article 317, as being derived from sources within the United States:

(2) Dividends other than those derived from sources within the United States as provided in section 217(a)(2) and article 318:

(3) Compensation for labor or services performed without the United States. For the treatment of compensation for labor or personal services performed partly within the United States and partly without the United States. See article 319.

(4) Rentals or royalties derived from property without the United States or from any interest in such property, including rentals or

royalties for the use of or for the privilege of using without the United States patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property. See article 320.

(5) Gain derived from the sale of real property located without the United States. See section 202.

ARR. 323. Sale of personal property.—Income derived from the purchase and sale of personal property shall be treated as derived entirely from the country in which sold. The word “sold” includes “exchanged” and ordinarily means the place where marketed. This article does not apply to income from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States or produced (in whole or in part) by the taxpayer without and sold within the United States. See article 327(b).

ARR. 324. Deductions in general.—The deductions provided for in section 214 shall be allowed to nonresident alien individuals and to citizens of the United States entitled to the benefits of section 262, and the deductions provided for in section 234 shall be allowed to foreign corporations and to domestic corporations entitled to the benefits of section 262, only if and to the extent that they are connected with income from sources within the United States. In the case of nonresident alien individuals, however, (1) 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, are deductible only if and to the extent that the profit, if such transaction had resulted in a profit, would have been taxable as income from sources within the United States; (2) losses sustained during the taxable year of property not connected with the trade or business if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insurance or otherwise are deductible only if the property was located within the United States; and (3) contributions or gifts made within the taxable year are deductible only if made to domestic corporations or to community chests, funds, or foundations created in the United States of the type specified in section 214(a)(11) and article 251, or to the vocational rehabilitation fund.

Losses embraced under clauses (2) and (3) above are deductible in full from items of gross income specified as being derived in full from sources within the United States, but if greater than the sum of such items, the excess of unabsorbed loss may be deducted from the income apportioned to sources within the United States under the provisions of article 327. Losses embraced under clause (1) are deductible in full (as provided in article 325 or article 326) when the

profit from the transaction, if it had resulted in a profit, would have been taxable in full as income from sources within the United States, but should be deducted under the provisions of article 327 when the profit from the transaction, if it had resulted in profit, would have been taxable only in part. The amount of dividends included in the gross income may be deducted or credited, but in the case of a non-resident alien individual, for the purpose of the normal tax only.

ART. 325. Apportionment of deductions.—From the items specified in articles 317–323 as being derived specifically from sources within and without the United States there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any other expenses, losses, or deductions which can not definitely be allocated to some item or class of gross income. The remainder shall be included in full as income from sources within the United States. The ratable part is based upon the ratio of gross income from sources within the United States to the total gross income.

Example.—A nonresident alien individual derived gross income from all sources for 1921 of \$180,000. There was included therein:

- \$9,000 interest on bonds of a domestic corporation.
- 4,000 dividends on stock of a domestic corporation.
- 12,000 royalty for the use of patents within the United States.
- 11,000 gain from the sale of real property located within the United States.

\$36,000 total.

That is, one-fifth of the total gross income was from sources within the United States. The remainder of the gross income was from sources without the United States, determined under article 322 above.

The expenses of the taxpayer for the year amounted to \$78,000. Of these expenses the amount of \$8,000, including such items as commission paid for the sale of the real property located within the United States and interest on indebtedness incurred to purchase the stock of a domestic corporation, is properly allocated to income from sources within the United States and the amount of \$40,000 is properly allocated to income from sources without the United States.

The remainder of the expenses, \$30,000, can not be definitely allocated to any class of income. A ratable part thereof, based upon the relation of gross income from sources within the United States to the total gross income, shall be deducted in computing net income from sources within the United States. Thus, there is deducted from the \$36,000 of gross income from sources within the United States, expenses amounting to \$14,000 (representing \$8,000 properly apportioned to the income from sources within the United States and \$6,000, a ratable part (one-fifth) of the expenses which

could not be allocated to any item or class of gross income). The remainder, \$22,000, is the net income from sources within the United States.

ART. 326. Other income from sources within the United States.—Items of gross income other than those specified in section 217 (a) and (c) and articles 317–323 shall be allocated or apportioned to sources within or without the United States, as provided in subdivision (e) of section 217.

The income derived from the ownership or operation of any farm, mine, oil or gas well, other natural deposit, or timber, located within the United States, and from the sale by the producer of the products thereof within or without the United States, shall ordinarily be included in gross income from sources within the United States. If, however, it is shown to the satisfaction of the Commissioner that due to the peculiar conditions of production and sale in a specific case or for other reasons all of such gross income should not be allocated to sources within the United States, an apportionment thereof to sources within the United States and to sources without the United States shall be made as provided in article 327.

Where items of gross income are separately allocated to sources within the United States, there shall be deducted therefrom, in computing net income, the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of other expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income.

ART. 327. Income derived from sources partly within and partly without the United States.—Items of gross income not allocated by articles 316–323 or 326 to sources within or without the United States shall (unless unmistakably from a source within or a source without the United States) be treated as derived from sources partly within and partly without the United States, according to the following rules and cases:

Manufacturers and producers.—Gross income derived from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States, or produced in whole or in part by the taxpayer without and sold within the United States shall be treated as derived partly from sources within and partly from sources without the United States, under one of the cases named below. As used herein, the word “produced” includes created, fabricated, manufactured, extracted, processed, cured, or aged.

Case 1: Where the manufacturer or producer regularly sells part of his output to wholly independent distributors or other selling con-

cerns in such a way as to establish fairly an independent factory or production price—or shows to the satisfaction of the Commissioner that such an independent factory or production price has been otherwise established—unaffected by considerations of tax liability, and the selling or distributing branch or department of the business is located in a different country than that in which the factory is located or the production carried on, the net income attributable to sources within the United States shall be computed by an accounting which treats the products as sold by the factory or productive department of the business to the distributing or selling department at the independent factory price so established. In all such cases the basis of the accounting shall be fully explained in a statement attached to the return.

Case 2: Where an independent factory or production price has not been established as provided under case 1, the net income shall first be computed by deducting from the gross income derived from sources partly within and partly without the United States the expenses, losses, or other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income. Of the amount of net income so determined, one-half shall be apportioned in accordance with the value of the taxpayer's property within and without the United States, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the value of the taxpayer's property within the United States and the denominator of which consists of the value of the taxpayer's property both within and without the United States. The remaining one-half of such net income shall be apportioned in accordance with the gross sales of the taxpayer within and without the United States, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the taxpayer's gross sales for the taxable year or period within the United States, and the denominator of which consists of the taxpayer's gross sales for the taxable year or period both within and without the United States. "Gross sales within the United States" means the aggregate amount of all sales made during the taxable year which were principally secured, negotiated or effected by employees, agents, offices, or branches of the taxpayer's business resident or located in the United States.

The term "property" as used in this article includes only the property held or used to produce income which is derived from sources partly within and partly without the United States (exclud-

ing all property held or used to produce income which is allocated or apportioned under other articles or paragraphs of these regulations). Such property should be taken at its actual value, which in the case of property valued or appraised for purposes of inventory, depreciation, depletion, or other purposes of the Revenue Act of 1921 shall be the highest amount at which so valued or appraised, and which in other cases shall be deemed to be its book value in the absence of affirmative evidence showing such value to be greater or less than the actual value. The average value during the taxable year or period shall be employed. The average value of property as above prescribed at the beginning and end of the taxable year or period ordinarily may be used, unless by reason of material changes during the taxable year or period, such average does not fairly represent the average for such year or period, in which event the average shall be determined upon a monthly or daily basis. Bills and accounts receivable shall (unless satisfactory reason for a different treatment is shown) be assigned or allocated to the United States when the debtor resides in the United States, unless the taxpayer has no office branch or agent in the United States.

Case 3: Application for permission to base the return upon the taxpayer's books of account will be considered by the Commissioner in the case of any taxpayer who, in good faith and unaffected by considerations of tax liability, regularly employs in his books of account a detailed allocation of receipts and expenditures which reflects more clearly than the processes or formulas prescribed under cases 1 and 2, the income derived from sources within the United States.

ART. 328. Computation of income.—Where a taxpayer has gross income from sources within or without the United States as defined by section 217(a) or (c) together with gross income derived partly from sources within and partly from sources without the United States, the amounts thereof, together with the expenses and investment applicable thereto shall be segregated, and the net income from sources within the United States shall be separately computed therefrom.

ART. 329. Allowance of deductions and credits.—Unless a nonresident alien individual, a foreign corporation, or a citizen of the United States or domestic corporation entitled to the benefits of section 262, shall file, or cause to be filed with the collector, a true and accurate return of income from sources within the United States, regardless of amount, the tax shall be collected on the basis of the gross income (not the 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 it upon filing a return of income, except as permitted in articles 315 and 364. See section 216 of the statute and article 306.

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.

(b) 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.

(c) 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.

(d) 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.

This subdivision shall not be in effect after December 31, 1921. In the case of a personal service corporation having a fiscal year beginning in 1921 and ending in 1922, amounts distributed prior to January 1, 1922, to its stockholders out of earnings or profits accumulated after December 31, 1920, shall be taxed to the distributees; and the stockholders of record on December 31, 1921, shall be taxed upon their distributive shares of the difference (if any) between such distributive

profits and the portion of the corporation's net income assignable to the calendar year 1921, determined in the manner provided in clause (1) of subdivision (c) of section 205 of this Act.

ART. 331. 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 partnership, whether distributed or not, and are required to include such distributive shares in their returns. The net income of the 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, as these are allowable deductions to the respective partners in their individual returns. See section 212 and articles 21–26. In the case of a partnership closely related to other trades or businesses, see section 240(d) and article 637.

ART. 332. Distributive shares of partners.—The distributive share of the net income of the 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 partners in their returns for their next succeeding taxable years. Where the result of partnership operation is a net loss, the loss will be divisible by the partners in the same proportion as net income would have been divisible, unless the partnership agreement provides for the division of a loss in a manner different from the division of a gain, and may be used by the individual partners in their returns of income.

ART. 333. 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 proportionate shares of such dividends specified in section 216 (a) and article 301, 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 or to any possession of the United States subject to the limitations of section 222 of the statute. See sections 216 and 222 and articles 301 and 381-386.

ART. 334. Taxation of partners in partnership with fiscal year ending in 1921.—If the fiscal year of a partnership began in the calendar year 1920 and ended in the calendar year 1921, the method of computing the taxes of the partners is as follows: (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 1920 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 1920 (Title II of the Revenue Act of 1918) and the distributive share thereof of each partner, and then taking such proportion of that distributive share as the part of the taxable period falling within the calendar year 1920 bears to the entire taxable period; (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 1921 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 1921 and the distributive share thereof of each partner, and then taking such proportion of that distributive share as the part of the taxable period falling within the calendar year 1921 bears to the full taxable period. See section 205 (c) of the statute and article 1621.

ART. 335. Taxation of partners in partnership with fiscal year ending in 1922.—If the fiscal year of the partnership began in the calendar year 1921 and ends in the calendar year 1922 the rates of tax for the calendar year 1921 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 1921, and the rates for the calendar year 1922 to the amount of each partner's distributive share of such income of the partnership attributable to the calendar year 1922. (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 1921 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 1921 and the distributive share thereof of each partner, and then taking such proportion of the distributive share as the part of the taxable period falling within the calendar year 1921 bears to the entire taxable period; (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 1922 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 1922 and the distributive share thereof of each partner, and then taking

such proportion of that distributive share as the part of the taxable period falling within the calendar year 1922 bears to the entire taxable period. See section 205(c) of the statute and article 1621. In determining the rates of tax applicable to the amounts of the distributive shares of the partners attributable to the calendar years 1921 and 1922, respectively, the amounts subject to the rates for the calendar year 1922 shall be placed in the lower brackets of the rates schedule provided in the present statute, and the amounts attributable to the calendar year 1921 in the next higher brackets of the rates schedule applicable to that year.

ART. 336. Personal service corporations.—Subdivision (d) of section 218 repeals as of December 31, 1921, the special method of taxing stockholders of a personal service corporation instead of the corporation itself. For the calendar year 1921 such corporations are not subject to tax as corporations but they are required to make returns of income on Form 1065. See sections 231, 239, and 304 of the statute and the articles thereunder. An individual stockholder of a personal service corporation is subject to tax much like a member of a partnership upon his distributive share of the net income of the corporation earned on or after January 1, 1918, and prior to January 1, 1922. The net income of a personal service corporation attributable to the period prior to January 1, 1922, 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. Personal service corporations are defined in section 200 of the statute. See article 1523.

Earnings of a personal service corporation attributable to a period subsequent to December 31, 1921, are taxed to the corporation the same as the earnings of ordinary corporations and the return of income must be made upon Form 1120. See section 239 and articles thereunder.

ART. 337. Personal service corporation with fiscal year ending in 1921 or 1922.—In the case of a personal service corporation having a fiscal year beginning in 1920 and ending in 1921, the corporation must make a return of income on Form 1065. The income for such year is not taxable to the corporation, but is taxable to the shareholders in a manner similar to that in which the earnings of partnerships are taxed. See articles 331-335.

In the case of a personal service corporation having a fiscal year beginning in 1921 and ending in 1922, the return must be filed both on Form 1065 and on Form 1120. The net income attributable to the calendar year 1921 is that portion of the net income reflected

upon Form 1065 (computed as if the fiscal year were the calendar year 1921), which the part of the taxable period falling within the calendar year 1921 bears to the entire period; and this amount is taxable to the shareholders of the corporation at the rates in effect as of December 31, 1921. See article 338. The income attributable to the calendar year 1922 is that portion of the net income reflected upon Form 1120 (computed as if the fiscal year were the calendar year 1922), which the part of the taxable period falling within the calendar year 1922 is of the entire period; and this amount is taxable to the corporation as the income of ordinary corporations is taxed. See sections 205 and 335 of the statute and articles 1621-1624 and 951.

ART. 338. Distributive shares of stockholders in personal service corporation.—A stockholder of a personal service corporation is required to include in his gross income for each taxable year up to and including that taxable year within which falls the end of the last taxable period of the personal service corporation prior to January 1, 1922: (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 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 1541-1549.

In the case of a personal service corporation having a fiscal year beginning in 1921 and ending in 1922, amounts distributed prior to January 1, 1922, to its stockholders out of earnings or profits accumulated during its current taxable year are taxable to the distributees and should be reported in the personal returns of such distributees, and the stockholders of record on December 31, 1921, of such personal service corporation must report as income their distributive shares of the difference (if any) between such distributive profits and the portion of the corporation's net income assignable to the calendar year 1921, determined in the manner provided in section 205(c) (1) of the statute and articles 334, 335 and 337.

The earnings of the personal service corporation attributable to the period subsequent to December 31, 1921, are taxable to the stockholder only when distributed, as in the case of dividends of ordinary corporations. See section 201 and article 1541.

ART. 339. 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, except such amounts as represent earnings of the personal service corporation accumulated after December 31, 1917, and prior to January 1, 1922, which would have been taxed directly to the stockholder. 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 relative to income properly allocated to the period beginning with January 1, 1918, and ending with December 31, 1921, 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 and interest allowed as credits by section 216 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 or to any possession of the United States, subject to the limitations of section 222 of the statute. See articles 381-386.

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 (in lieu of the deduction authorized by paragraph (11) of subdivision (a) of section 214) there shall also be allowed as a deduction, without limitation, 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 or permanently set aside for the purposes and in the manner specified in paragraph (11) of subdivision (a) of section 214. In cases in which there is any income of the class described in paragraph (4) of subdivision (a) of this section the fiduciary shall include in the return a statement of the income of the estate or trust which, pursuant to the instrument or order governing the distribution, is distributable to each beneficiary, whether or not distributed before the close of the taxable year for which the return is made.

(c) In cases under paragraphs (1), (2), or (3) of subdivision (a) or in any other case within subdivision (a) of this section except paragraph (4) thereof 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 that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, whether distributed or not, or, if his taxable year is different from that of the estate or trust, then there shall be included in computing his net income his distributive share of the income of the estate or trust for its taxable year ending within the taxable year of the beneficiary. 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.

(e) In the case of an estate or trust the income of which consists both of income of the class described in paragraph (4) of subdivision (a) of this section and other income, the net income of the estate or trust shall be computed and a return thereof made by the fiduciary in accordance with subdivision (b) and the tax shall be imposed, and shall be paid by the fiduciary in accordance with subdivision (c), except that there shall be allowed as an additional deduction in computing the net income of the estate or trust that part of its income of the class described in paragraph (4) of subdivision (a) which, pursuant to the instrument or order governing the distribution, is distributable during its taxable year to the beneficiaries. In cases under this subdivision there shall be included, as provided in subdivision (d) of this section, in computing the net income of each beneficiary, that part of the income of the estate or trust which, pursuant to the instrument or order governing the distribution, is distributable during the taxable year to such beneficiary.

(f) A trust created by an employer as a part of a stock bonus or profit-sharing plan for the exclusive benefit of some or all of his employees, to which contributions are made by such employer, or employees, or both, for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan, shall not be taxable under this section, but the amount actually distributed or made available to any distributee shall be taxable to him in the year in which so distributed or made available to the extent that it exceeds the amounts paid in by him. Such distributees shall for the purpose of the normal tax

be allowed as credits that part of the amount so distributed or made available as represents the items specified in subdivisions (a) and (b) of section 216.

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, without limitation, from the gross income any part of it which during the taxable year is pursuant to the will or trust deed paid or permanently set aside in the manner specified in section 214(a) (11). See section 212 and articles 21–26.

ART. 342. Estates and trusts taxed to fiduciary.—In the case of (a) estates of decedents before final settlement, (b) trusts, whether created by will or deed, for accumulation of income, whether for unascertained persons or persons with contingent interests or otherwise, and in any other case within section 219(a) except paragraph 4 thereof, 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 the discretion. The imposition of the tax is not affected by the fact that an ultimate beneficiary may be a person exempt from tax. An 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, or may be capital gain, taxable to the estate. See articles 1562 and 1563.

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 his taxable year is different from that of the estate or trust, then he need only include in computing his net income his distributive share of the income of the estate or trust for its taxable year ending within his taxable year. The regulations governing partnerships are generally applicable to such an estate or trust. See articles 331–335.

ART. 346. Credits to trust or beneficiary.—(a) An estate or trust taxed to the fiduciary 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 as described in article 301 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 301–306.

ART. 347. Estates and trusts with income which is distributed periodically, and other income.—In the case of an estate or trust, the income of which consists both of income to be distributed to beneficiaries periodically and other income, the net income of the estate or trust shall be computed and a return thereof made by the fiduciary in accordance with section 219(b) and the tax shall be imposed and paid by the fiduciary in accordance with section 219(c), except that there shall be allowed as an additional deduction in computing the net income of the estate or trust that part of its income of the class described in section 219(a)(4) which, pursuant to the will or trust deed, is distributable during its taxable year to the beneficiaries. Each of such beneficiaries shall include, in computing his net income, that part of the income of the estate or trust which, pursuant to the instrument or order governing the distribution, is distributable to him during the taxable year.

ART. 348. Stock bonus or profit-sharing trust.—Subdivision (f) of section 219 provides that a trust created by an employer as a part of a stock bonus or profit-sharing plan for the exclusive benefit of some or all of his employees, to which contributions are made by such employer, or employees, or both, for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan, shall not be taxable under this section, but the amount actually distributed or made available to any distributee shall be taxable to him in the year in which so distributed or made available to the extent that it exceeds the amounts paid in by him. Such distributees shall for the purpose of the normal tax be allowed as credits that part of the amount so distributed or made available as represents the dividend and interest items specified in subdivisions (a) and (b) of section 216.

EVASION OF SURTAXES BY INCORPORATION.

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, there shall be levied, collected, and paid for each taxable year upon the net income of such corporation a tax equal to 25 per centum of the amount thereof, which shall be in addition to the tax imposed by section 230 of this title and shall be computed, collected, and paid upon the same basis and in the same manner and subject to the same provisions of law, including penalties, as that tax: *Provided*, That if all the stockholders or members of such corporation agree thereto, the Commissioner may, in lieu of all income, war-profits and excess-profits taxes imposed upon the corporation for the taxable year, tax the stockholders or members of such corporation upon their distributive shares in the net income of the corporation for the taxable year in the same manner as provided in subdivision (a) of section 218 in the case of members of a partnership. The fact that any corpora-

tion 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 be subject to an income tax at 25 per cent in addition to the taxes imposed by section 230 of the statute. If, however, all the stockholders agree thereto, the Commissioner may, in lieu of all income, war-profits and excess-profits taxes imposed upon the corporation for the taxable year, tax them upon their distributive shares in the net income of the corporation for the taxable year as provided in subdivision (a) of section 218, in the case of members of a partnership. 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 shareholding of the stockholders, and of the amounts that would be payable to each.

ART. 352. Purpose to escape surtax.—Section 220 of the statute applies where a corporation is formed or availed of for the purpose of preventing the imposition of the surtax upon its stockholders or members by permitting its gains and profits to accumulate instead of being divided or distributed. Prima facie evidence of a purpose to escape the surtax 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 anything further 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 INDIVIDUAL'S 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 (except interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States and not having an office or place of business therein), 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 or partnership composed in whole or in part of nonresident aliens (other than income received as dividends of the class allowed as a credit by subdivision (a) of section 216) 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 withhold 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 subdivision (g) of 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 1 of each year and shall on or before June 15 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 payable to a nonresident alien individual or to a partnership composed in whole or in part of nonresident aliens and having no office or place of business within the United States, except (1) dividends of a class allowed as a credit by subdivision (a) of section 216, (2) interest on deposits with persons carrying on the banking business, paid to persons not engaged

in business in the United States and not having an office or place of business therein, and (3) interest upon corporate bonds containing a tax-free covenant clause; (b) of a tax of 10 per cent for the calendar year 1921 and 12½ per cent for subsequent years in the case of fixed or determinable annual or periodical income (with the exceptions just stated) 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 like obligations 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 corporate 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.

A debtor corporation having an issue of bonds or other similar obligations may appoint a duly authorized withholding agent to act in its behalf, provided notice of such appointment is filed with the Commissioner.

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 1 following the taxable year, an ownership certificate on Form 1001 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 with withholding agents, who shall forward such certificates to the Commissioner with a letter of transmittal. See article 315. No withholding from corporate dividends (other than distributions by a personal service corporation prior to January 1, 1922) is required in any case. The income of domestic and resident foreign corporations is free from withholding.

ART. 364. Exemption certificates of nonresident aliens.—(a) When the gross income (including bond interest) of a nonresident alien, which is derived from sources within the United States, does not exceed the personal exemption of \$1,000, allowed by section 216(e), an exemption certificate, Form 1001 B, should be executed and filed with the withholding agent, if any part of the gross income is derived from interest upon bonds or similar obligations of a domestic corporation which contain a tax-free covenant clause. 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 such nonresident alien upon tax-free covenant bonds during the calendar year.

(b) When the gross income of a nonresident alien, derived from sources within the United States, does not exceed \$1,000, such person may file with the withholding agent an exemption certificate on Form 1001 C with respect to interest upon bonds or similar obligations of a domestic corporation not containing a tax-free covenant clause. The debtor organization or withholding agent, upon receipt of a properly executed certificate showing that the individual's income does not exceed \$1,000, shall release and pay over to such individual upon demand any tax withheld during the preceding calendar year. The tax assessed against the withholding agent and which has not been paid may be made the subject of a claim for abatement to the extent of the amount of excess tax withheld, and refunded to the alien on the basis of this certificate. In case the tax so withheld has been paid to the Government, refund of the tax withheld in the case of nontax-free bonds and similar obligations can only be made to the bond owner or his duly authorized representative.

The exemption certificates, Forms 1001 B and 1001 C, properly executed, may be filed with the debtor organization or its duly authorized withholding agent at any time after the close of the calendar year, but not later than May 1 of the succeeding year. Ownership certificates, however, must be filed in connection with all interest payments upon bonds and similar obligations of domestic corporations in accordance with the regulations, notwithstanding the fact that Form 1001 B or Form 1001 C is filed.

ART. 365. Ownership certificates for interest coupons.—The owners of bonds or other obligations, except domestic and resident corporations, whether or not such bonds or other obligations contain 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 74–84. 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 1077.

ART. 366. Form of certificate where withholding required.—For the purposes of article 365, Form 1000 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, by partnerships composed in whole or in part of nonresident aliens and not having an office or place of business within the United States, 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 (prior to Jan. 1, 1922) 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. 367. Form of certificate where no withholding required.—For the purposes of article 365, Form 1001 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 and resident partnerships, in the case of bonds not containing 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.

ART. 368. 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 or Form 1059, 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. 369. Interest coupons without ownership certificates.—When interest coupons are received unaccompanied by certificates of ownership, unless the first bank be satisfied that the owner is a domestic or resident corporation, the first bank shall require of the payee a statement 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 statement shall be forwarded to the Commissioner with the monthly return on Form 1012. The first bank receiving such coupons shall also prepare a certificate on Form 1000, 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 "Statement furnished," adding the name of the bank.

ART. 370. Interest on registered bonds.—Ownership certificates are required in connection with interest upon registered bonds the same as interest upon any other class of bonds. If ownership certificates are not furnished by the owner of the bonds, such certificates must be prepared by the debtor corporation or its withholding agent. (a) If the bonds contain a tax-free covenant clause, ownership certificates must be prepared on Form 1000 for the following classes of bondholders: Citizens or residents of the United States, nonresident alien individuals, partnerships, whether foreign or domestic, foreign corporations having no office or place of business within the United States. (b) If the bonds do not contain a tax-free covenant clause, Form 1000 shall be prepared in the case of nonresident alien individuals, partnerships composed in whole or in part of nonresident aliens and not having an office or place of business within the United States, or in case the owner is a foreign corporation not engaged in trade or business within the United States and not having an office or place of business therein. If ownership certificates are not filed by a citizen or resident of the United States or a resident partnership in connection with interest payments upon registered bonds not containing a tax-free covenant clause, Form 1001 should be prepared by the debtor corporation or its withholding agent.

Regardless of whether the registered bonds do or do not contain a tax-free covenant clause, no ownership certificate is required in connection with such bonds owned by domestic or resident corporations.

ART. 371. 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. He shall also make a monthly return on Form 1012 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 Commissioner 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, showing the amount of tax required

to be withheld for each nonresident alien individual, partnership composed in whole or in part of nonresident aliens and not having an office or place of business within the United States, 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(a). Withholding—Partnerships.—The Revenue Act of 1921 provides for withholding in the case of payments made to a partnership composed in whole or in part of nonresident aliens. This provision does not apply to such payments made prior to November 23, 1921. However, in the case of a partnership having an office or place of business in the United States, withholding will not be required (except in the case of interest upon tax-free bonds) 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, should file a return of the income of such nonresident alien member or members in accordance with the provisions of article 404.

ART. 372. Release of tax withheld from interest on bank deposits.—Under the Revenue Act of 1921 persons carrying on the banking business within the United States are not required to withhold any tax from interest on bank deposits which is paid to (or credited to the accounts of) persons not engaged in business within the United States and not having an office or place of business therein. Any tax which, subsequent to December 31, 1920, and pursuant to the Revenue Act of 1918, had been withheld by persons carrying on the banking business within the United States from interest on bank deposits paid to (or credited to the accounts of) nonresident alien individuals not engaged in business within the United States and not having an office or place of business therein, or foreign corporations not engaged in business within the United States and not having an office or place of business therein, shall be released and paid over to such nonresident alien individual or foreign corporation, or his or its representative.

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 filed in connection with such payments shall be trans-

mitted 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 371.

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 two or more persons, a separate ownership certificate must be executed in behalf of each of the owners.

ART. 375. 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 IN CASE OF INDIVIDUALS.

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 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, the amount of any such taxes paid during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, 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.

(5) The above credits shall not be allowed in the case of a citizen entitled to the benefits of section 262; and in no other case shall the amount of credit taken under this subdivision exceed the same proportion of the tax, against which such credit is taken, which the taxpayer's net income (computed without deduction for any income, war-profits and excess-profits taxes imposed by any foreign country or possession of the United States) from sources without the United States bears to his entire net income (computed without such deduction) for the same taxable year.

(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 without the United States, and all other information necessary for the verification and computation of such credits.

(d) If the taxpayer makes a return for a fiscal year beginning in 1920 and ending in 1921, the credit for the entire fiscal year shall, notwithstanding any provision of this Act, be determined under the provisions of this section; and the Commissioner is authorized to disallow, in whole or part, any such credit which he finds has already been taken by the taxpayer.

ART. 381. Analysis of credit for taxes.—(1) In the case of a citizen of the United States, whether resident or 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 foreign country or to any possession of the United States"; and (b) his "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 such

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, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country"; and (c) his "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 any foreign country, if the foreign country of which such alien resident is a citizen or subject, 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 articles 611 and 612.

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 section 217. See also section 2 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 in 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 1329 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 1921, 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, 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 1921, 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, 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, Dutch Guiana, Ecuador, Egypt, Finland, France, Great Britain and Ireland, Guatemala, Herzegovina, India, Jamaica, Japan, Montenegro, Morocco, New Zealand, Nicaragua, Panama,

Paraguay, Persia, Peru, Portugal, Rumania, Santo Domingo, Serbia, Siam, Straits Settlements, 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 1921 (as to fiscal years beginning in 1920, see art. 386) 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 any foreign country. 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.

Art. 386. Fiscal year beginning in 1920 and ending in 1921.—In the case of a fiscal year beginning in 1920 and ending in 1921 there shall be no prorating of the tax credits allowed by the Revenue Act of 1918 and by section 222, but the tax credits for such fiscal year shall be determined entirely under the provisions of this section. The Commissioner is authorized to disallow any such credit which he finds has already been taken by the taxpayer.

INDIVIDUAL RETURNS.

Sec. 223. (a) That the following individuals shall each make under oath a return stating specifically the items of his gross income and the deductions and credits allowed under this title—

(1) 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;

(2) Every individual having a net income for the taxable year of \$2,000 or over, if married and living with husband or wife; and

(3) Every individual having a gross income for the taxable year of \$5,000 or over, regardless of the amount of his net income.

(b) If a husband and wife living together have an aggregate net income for the taxable year of \$2,000 or over, or an aggregate gross income for such year of \$5,000 or over—

(1) Each shall make such a return, or

(2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income.

(c) 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.—For each taxable year every single person whose gross income, as defined in section 213 of the statute, is \$5,000 or over, or whose net income, as defined in section 212 of the statute and articles 21–26, is \$1,000 or over, must make a return

of income. 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 unless their aggregate gross income is at least \$5,000 or their aggregate net income is at least \$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 gross income is \$5,000 or over, or their aggregate net income is \$2,000 or over, unless they join in a single joint return. Where the income of each is included in a single joint return, the tax is computed on the aggregate income and all deductions and credits to which either is entitled shall be taken from such aggregate income. 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 441-447.

ART. 402. Form of return.—The return shall be on Form 1040, except that it may be on short Form 1040 A 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 may be had from the collectors of the several districts. 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 1055.

ART. 403. Return of income of minor.—An individual under the statutory age of majority is required to render a return of income if he has a net income of his own of \$1,000 or over, or a gross income of \$5,000 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, or his gross income is at least \$5,000, 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. In the absence of proof to the contrary, a parent will be assumed to have the legal right to the earnings of the minor and must include them in his return.

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 B 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 375.

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 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 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 331-335. 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. See also sections 222 and 227 and articles 381-386 and 441-447.

FIDUCIARY RETURNS.

Sec. 225. (a) That every fiduciary (except a receiver appointed by authority of law in possession of part only of the property of an individual) shall make under oath a return for any of the following individuals, estates, or trusts for which he acts, stating specifically the items of gross income thereof and the deductions and credits allowed under this title—

(1) 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;

(2) Every individual having a net income for the taxable year of \$2,000 or over, if married and living with husband or wife;

(3) Every individual having a gross income for the taxable year of \$5,000 or over, regardless of the amount of his net income;

(4) Every estate or trust the net income of which for the taxable year is \$1,000 or over; and

(5) Every estate or trust of which any beneficiary is a nonresident alien.

(b) 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 sufficient compliance with the above requirement. Such fiduciary shall make oath (1) that he has sufficient knowledge of the affairs of the individual, estate or trust for which the return is made, to enable him to make the return, and (2) that the return is, to the best of his knowledge and belief, true and correct. Any fiduciary required to make a return 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 gross income of such individual is \$5,000 or over, or 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, or on Form 1040 A if the net income does not exceed \$5,000. In cases under (b) where the tax is payable by the beneficiaries the return shall be made on Form 1041. 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 341-348. If the net income of a decedent from the beginning of the taxable year to the date of his death was at the rate of \$1,000 or more a year if unmarried, or \$2,000 or more a year if married, or if his gross income for the same period was at the rate of \$5,000 or over a year, the executor or administrator shall make a return for such decedent. See section 226 and articles 305 and 431.

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, or having a gross income of \$5,000 or over, must make a return for such minor on Form 1040 or 1040 A and pay the tax, unless such minor himself makes a return or causes it to be made. A fiduciary acting as a guardian or 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, or having a gross income of \$5,000 or over, must make a return for such incompetent on Form 1040 or 1040 A 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 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 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 or 1040 A. 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. 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 the income of a trust any beneficiary of which is a nonresident alien, the fiduciary shall make a return on Form 1040 B for such nonresident alien and pay any tax shown thereon to be due. Unless such return is a true and accurate return of the nonresident alien beneficiary's income from all sources within the United States the benefits of the credits and deductions to which the beneficiary is entitled can not be obtained in the return filed by the fiduciary. See section 217(g). If the beneficiary appoints a person in the United States to act as his agent for the purpose of rendering income tax returns the fiduciary shall be relieved from the necessity of filing Form 1040 B in behalf of the beneficiary and from paying the tax. In such a case the fiduciary shall make a return on Form 1041 and attach thereto a copy of the notice of appointment. If there are two or more nonresident alien beneficiaries the fiduciary shall render a return on Form 1041 and also a return on Form 1040 B for each nonresident alien beneficiary. In no case will a fiduciary be required to withhold tax at the rate of 8 per cent and render a return on Form 1042 with respect to income of a nonresident alien beneficiary, as a complete return thereof will be included in Form 1040 B. See further article 404.

RETURNS FOR A PERIOD OF LESS THAN TWELVE MONTHS.

SEC. 226. (a) 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.

(b) In all cases where a separate return is made for a part of a taxable year 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.

(c) In the case of a return for a period of less than one year the net income shall be placed on an annual basis by multiplying the

amount thereof by twelve and dividing by the number of months included in such period; and the tax shall be such part of a tax computed on such annual basis as the number of months in such period is of twelve months.

ART. 431. Returns for periods of less than twelve months.—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. 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 441–447 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. In any case of a return for a period of less than one year the net income shall be placed on an annual basis and the tax computed as provided in subdivision (c) of section 226. See illustration below. See further section 212 and articles 25 and 26, and as to corporations sections 232 and 239 and articles 531 and 626.

Illustration of computation of tax for a period of less than one year.—For the calendar year 1921 the income tax of a married person entitled to a personal exemption of \$2,000, making a return for a six months' period of \$10,000 net income, is \$995, computed as follows:

Net income.....	\$10,000
Multiplied by 12.....	120,000
Divided by 6.....	20,000
Subtracting exemption of \$2,000.....	18,000
Normal tax on \$18,000.....	1,280
Surtax on \$20,000.....	710
	1,990
Total.....	1,990
Divided by 2.....	995

TIME AND PLACE FOR FILING INDIVIDUAL, PARTNERSHIP, AND FIDUCIARY RETURNS.

SEC. 227. (a) That returns (except in the case of nonresident aliens) 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 15th day of March. In the case of a nonresident alien individual returns shall be made on or before the fifteenth day of the sixth 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 15th day of June. The Commissioner may grant a reasonable exten-

sion 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 on a calendar year basis must be made on or before the fifteenth day of March following the taxable year, and returns on the basis of a fiscal year must be made on or before the fifteenth day of the third month following the close of the fiscal year. Returns in the case of nonresident aliens must be made on or before the fifteenth day of the sixth month following the close of the fiscal year or on or before the fifteenth day of June, if on the basis of the calendar year. See also sections 250 and 253 of the statute and articles 1001–1013 and 1055.

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. See section 250(d) and article 1012.

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

due date of the return. 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 and the payment of one-fourth of the estimated amount of tax. A tentative return should be made on the usual return form, plainly marked "tentative" at the top, contain a statement as to the estimated amount of tax believed to be due, and be properly executed. No other data need be given. Tentative returns will not be accepted unless permission is obtained previous to filing. A copy of the authority for filing the tentative return must be attached thereto when filed. 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. As to interest see article 1003. Collectors should not grant extensions of time for filing Forms 1096 and 1099. Requests for such extensions should be made to the Commissioner.

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. As to interest, see article 1003; as to extension of time for payment in certain cases where a deficiency in tax is discovered, see article 1014.

ART. 445. Extension of time in the case of persons abroad.—Where a delinquent return is filed by or on behalf of a person who is abroad, an affidavit must be attached to the return, stating the cause of the delay in filing it, in order that the Commissioner may determine whether the failure to file the return in time was due to a reasonable cause and whether 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. 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 case an extension is granted, interest is payable at the rate of one-half of 1 per cent per month from the time the tax would have been due if no extension had been granted.

ART. 446. 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 subsequent 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. 447. 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 Com-

missioner 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 has reason to believe 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 1300 of the statute and section 3176 of the Revised Statutes, as amended by section 1311 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 1311 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 1311 of the Revenue Act of 1918.

INCORPORATION OF INDIVIDUAL OR PARTNERSHIP BUSINESS.

SEC. 229. That in the case of the organization as a corporation within four months after the passage of this Act 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, 1921, to the date of such organization 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, 1921, and the undistributed profits or earnings of such trade or business shall not be subject to the surtaxes imposed in section 211, but amounts distributed on and after January 1, 1921, from the earnings or profits of such trade or business accumulated after December 31, 1920, 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 section shall not apply to any trade or business, the net income of which for the taxable year 1921 was less than 20 per centum of its invested capital for such year: *Provided further*, That any taxpayer who takes advantage of this section shall pay the tax imposed by section 1000 of the Revenue Act of 1918 as if such taxpayer had been a corporation on and after January 1, 1921.

PART II A.
INCOME TAX ON CORPORATIONS.

TAX ON CORPORATIONS.

SEC. 230. That, in lieu of the tax imposed by section 230 of the Revenue Act of 1918, there shall be levied, collected, and paid for each taxable year upon the net income of every corporation a tax at the following rates:

(a) For the calendar year 1921, 10 per centum of the amount of the net income in excess of the credits provided in section 236; and

(b) For each calendar year thereafter, 12½ per centum of such excess amount.

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 continues in effect for the calendar year 1921 the war profits and excess profits tax on corporations. 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. For the income tax on life insurance companies, see sections 242–245; on insurance companies other than life or mutual (effective Jan. 1, 1922), sections 246–247. Mutual insurance companies other than life are taxed under section 230. As to foreign corporations, see section 233 (b); as to domestic corporations deriving 80 per cent of their gross income from sources within possessions of the United States, see section 262.

ART. 502. Rates of tax.—The income tax on corporations is at the rate of 10 per cent of the net income subject to tax for the calendar year 1921 and at the rate of 12½ per cent of the net income subject to tax for the calendar year 1922 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 (unless entitled to the benefits of section 262) 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 2 and articles 1501–1509.

CONDITIONAL AND OTHER EXEMPTIONS OF CORPORATIONS.

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 substantially all the business of which is confined to making loans to members; 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 or which are not operated for profit; and any corporation chartered solely for burial purposes as a cemetery corporation and not permitted by its charter to engage in any business not necessarily incident to that purpose, no part of the net earnings of which inures to the benefit of any private stockholder or individual;
- (6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, 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; or organized and operated as purchasing agents for the purpose of purchasing supplies and equipment for the use of members and turning over such supplies and equipment to such members at actual cost, plus necessary expenses;

(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 depositories and financial agents for the United States, and for other purposes";

(14) Personal service corporations. This subdivision shall not be in effect after December 31, 1921.

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. Personal service corporations are not exempt after December 31, 1921; see section 218 of the statute and articles 336-339.

ART. 512. Agricultural and horticultural organizations.—Agricultural or horticultural organizations exempt from tax do not include corpo-

rations 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 any State, Territory, or the District of Columbia, which accumulates funds to be loaned primarily to its shareholders for the purpose of building or acquiring homes. In order to be exempt the association (1) must be mutual, that is, all of its stockholders or members must share in the profits on substantially the same footing; and (2) must be operated so that

substantially all of its business is confined to the making of loans to bona fide shareholders. A building and loan association otherwise exempt does not lose its exempt status 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.

(2) It borrows money (accepting deposits is held to be a form of borrowing) which it uses for loans to shareholders, the dues, fines, and penalties paid by shareholders being inadequate for this purpose.

(3) It makes loans to nonmembers from accumulated funds which are not needed for loans to shareholders. In any such case, however, the burden will be upon the association to show that substantially all of its loans are made to members.

(4) The amount of its prepaid or full-paid stock is disproportionate to running or installment stock, provided the issuance of such prepaid or full-paid stock is ancillary 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 running or installment stock to enable them to acquire or build homes.

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, being in substance and in fact the same as cooperative banks, are likewise exempt from tax.

ART. 516. Cemetery companies.—A cemetery company in order to be exempt must be owned and operated exclusively for the benefit of its lot owners or must not be operated for profit. Any cemetery corporation chartered solely for burial purposes and not permitted by its charter to engage in any business not necessarily incident to that purpose, no part of the net earnings of which inures to the benefit of any private stockholder or individual, is exempt from income tax. A cemetery company of which all lot owners are members, issuing preferred stock entitling the holder to a semiannual dividend of 4 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, literary, and educational organizations and community chests.—This exemption applies to corporations, associations, and community chests, funds, or foundations. In order to be exempt, the organization 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 net 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 by-laws 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. The fact that it engages in a regular business of a kind ordinarily carried on for profit but on a cooperative basis or so as to produce only sufficient income to be self-sustaining, is not ground for exemption. 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. Local 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. A farmers' mutual fire and lightning insurance company does not become taxable because it makes advance assessments for the sole purpose of meeting future losses and expenses, where any balance of such assessments remaining at the end of the year is retained to meet losses and expenses in the ensuing year. 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. An organization doing business on the "interindemnity" or "reciprocal insurance" plan through an attorney in fact subject to direction of an advisory board of policyholders, which requires advance deposits to cover the cost of the insurance and maintains investments or deposits from which substantial income is derived, is not exempt. 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 all the organizations enumerated in subdivision (10) of section 231. 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 organizations as are entirely and unqualifiedly "local" in their operations.

ART. 522. **Cooperative associations.**—(a) Cooperative associations, acting as sales agents for farmers, fruit growers, dairymen, etc., and turning back to them the proceeds of the sales, less the necessary selling expenses, on the basis of the produce furnished by them, are exempt from income tax. Thus 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, or if the association deducts more than necessary selling expenses, it does not meet the requirements of the statute and is not exempt. The maintenance of a reasonable reserve for depreciation or possible losses or a reserve required by State statute will not necessarily destroy the exemption.

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 farmers, will not for that reason be denied exemption.

(b) Cooperative associations organized and operated as purchasing agents for farmers, fruit growers, dairymen, etc., for the purpose of buying supplies and equipment for the use of members and turning over such supplies and equipment to members at actual cost, plus necessary expenses, are also exempt. In order to be exempt under either (a) or (b) an association must establish that it has no net income for its own account. An association acting both as a sales and a purchasing agent is exempt if as to each of its functions it meets the requirements of the statute.

NET INCOME OF CORPORATIONS 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. In the case of a foreign corporation or of a corporation entitled to the benefits of section 262 the computation shall also be made in the manner provided in section 217.

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; see also sections 217 and 262 and articles 311–329 and 1135–1137.

GROSS INCOME OF CORPORATIONS 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 sections 213 and 217, except that 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 means only gross income from sources within the United States, determined (except in the case of insurance companies subject to the tax imposed by sections 243 or 246) in the manner provided in section 217.

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. As to the basis for determining gain or loss on disposition of property, see section 202 and articles 1561-1569. Under the Revenue Act of 1921, the proceeds of life insurance policies paid upon the death of the insured to any beneficiary (corporate or otherwise) are not to be included in the beneficiary's gross income. See section 213(b)(1). In the case of mutual insurance companies and of foreign corporations, there are special provisions. See articles 549-550. As to domestic corporations deriving 80 per cent of their gross income from sources within possessions of the United States, see section 262. As to life insurance companies, see section 244 and article 671; as to other insurance companies (except mutual), see section 246 and article 692; but for 1921 such companies are within the provisions of section 233. Mutual insurance companies (other than life) are included within the provisions of section 233 and this article.

ART. 542. 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 341-348.

ART. 543. 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. 544. Contributions by stockholders.—Where a corporation requires additional funds for conducting its business and obtains such

needed money through voluntary prorata 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. 545. 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. 546. 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 appreciation 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, including any expenditures properly charged to capital account, or the fair market value as of March 1, 1913, of the assets acquired prior thereto, should first be reduced by the amount of depreciation, obsolescence, depletion, sustained and allowable, as a deduction in computing net income. 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 1561–1568 are particularly applicable.

ART. 547. 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. 548. 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 1545.

ART. 549. Gross income of mutual insurance companies.—The gross income of mutual insurance companies (other than life) 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 canceled 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 mutual 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 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 541 and 568-572.

ART. 550. Gross income of foreign corporations.—The gross income of a foreign corporation, including a mutual insurance company, means its gross income from sources within the United States, as defined and described in section 217 and articles 316-328 relating to nonresident alien individuals. As to other foreign insurance companies, see article 687. See also article 541.

DEDUCTIONS ALLOWED CORPORATIONS.

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, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title;

(3) Taxes paid or accrued within the taxable year except (a) income, war-profits, and excess-profits taxes imposed by the authority of the United States, (b) so much of the income, war-profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States as is allowed as a credit under section 238, and (c) taxes assessed against local benefits of a kind tending to increase the value of the property assessed. 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, nor shall such tax be included in the gross income of the obligee. The deduction allowed by this paragraph shall be allowed in the case of taxes imposed upon a shareholder or member of a corporation upon his interest as shareholder or member, which are paid by the corporation without reimbursement from the shareholder or member, but in such cases no deduction shall be allowed the shareholder or member for the amount of such taxes. For the purpose of this paragraph, estate, inheritance, legacy, and succession taxes accrue on the due date thereof except as otherwise provided by the law of the jurisdiction imposing such taxes;

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, unless, in order to clearly reflect the income, the loss should in the opinion of the Commissioner be accounted for as of a different period. No deduction shall be allowed for any loss claimed to have been sustained in any sale or other disposition of shares of stock or securities made after the passage of this Act where it appears that within thirty days before or after the date of such sale or other disposition the taxpayer has acquired (otherwise than by bequest or inheritance) substantially identical property, and the property so acquired is held by the taxpayer for any period after such sale or other disposition, unless such claim is made by a dealer in stock or securities and with respect to a transaction made in the ordinary course of its business. If such acquisition is to the extent of part only of substantially identical property, then only a proportionate part of the loss shall be disallowed. In case of

losses arising from destruction of or damage to property, where the property so destroyed or damaged was acquired before March 1, 1913, the deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913;

(5) Debts ascertained to be worthless and charged off within the taxable year (or in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt to be charged off in part;

(6) The amount received as dividends (A) from a domestic corporation other than a corporation entitled to the benefits of section 262, or (B) from any foreign corporation when it is shown to the satisfaction of the Commissioner that more than 50 per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the foreign corporation has been in existence) was derived from sources within the United States as determined under section 217;

(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of such property acquired before March 1, 1913, this deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913;

(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 war against the German Government, 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 such war, there shall be allowed, for any taxable year ending before March 3, 1924 (if claim therefor was made at the time of filing return for the taxable year 1918, 1919, 1920, or 1921) 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 before March 3, 1924, 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 income, war-profits, and excess-profits taxes 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: *And provided further*, That such depletion allowance based on discovery value shall not exceed the net income, computed without allowance for depletion, from the property upon which the discovery is made, except where such net income so computed is less than the depletion allowance based on cost or fair market value as of March 1, 1913; 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 (other than life insurance companies), in addition to the above (unless otherwise allowed): (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. After December 31, 1921, this subdivision shall apply only to mutual insurance companies other than life insurance companies;

(11) In the case of corporations (except those taxed under section 243) 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. This subdivision shall not be in effect after December 31, 1921;

(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, and paragraph (14), unless otherwise allowed, 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 (including inter-insurers and reciprocal underwriters, but not including 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, and paragraph (14), unless otherwise allowed, 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) If property is compulsorily or involuntarily converted into cash or its equivalent as a result of (A) its destruction in whole or in part, (B) theft or seizure, or (C) an exercise of the power of requisition or condemnation, or the threat or imminence thereof; and if the taxpayer proceeds forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, to expend the pro-

ceeds of such conversion in the acquisition of other property of a character similar or related in service or use to the property so converted, or in the acquisition of 80 per centum or more of the stock or shares of a corporation owning such other property, or in the establishment of a replacement fund, then there shall be allowed as a deduction such portion of the gain derived as the portion of the proceeds so expended bears to the entire proceeds. The provisions of this paragraph prescribing the conditions under which a deduction may be taken in respect of the proceeds or gains derived from the compulsory or involuntary conversion of property into cash or its equivalent, shall apply so far as may be practicable to the exemption or exclusion of such proceeds or gains from gross income under prior income, war-profits and excess-profits tax Acts.

(b) In the case of a foreign corporation or of a corporation entitled to the benefits of section 262 the deductions allowed in subdivision (a) shall be allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources within and without the United States shall be determined as provided in section 217 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 as provided in paragraph (6), of section 234 (a) and may not deduct charitable contributions. 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 131–135; as to losses see articles 141–147; as to bad debts see articles 151–155; as to depreciation see articles 161–171; as to amortization see articles 181–189; as to depletion see articles 201–237; as to involuntary conversion of property into cash or its equivalent see articles 261–263; as to life insurance companies see articles 681–687; and as to other insurance companies see article 568.

ART. 562. Donations.—Corporations are not entitled to deduct from gross income charitable or other contributions which individuals may deduct under paragraph (11) of section 214 (a). Donations made by a corporation for purposes connected with the operation of its business, however, 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. 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 543. 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 545 and 848. If (1) a corporation sells its capital assets for less than their cost, and such assets were acquired before March 1, 1913, then if the fair market value on March 1, 1913, less depreciation subsequently sustained and allowable as a deduction is less than the amount realized, no loss is deductible; if (2) such fair market value less depreciation subsequently sustained and allowable as a deduction is greater than the amount realized, but the amount realized exceeds original cost, no loss is deductible; if (3) the amount realized is less than both original cost and the value of March 1, 1913, less depreciation subsequently sustained and allowable as a deduction, the deductible loss is the difference between such amount realized and such cost or March 1, 1913, value, whichever is lower. See article 546.

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. Under the Revenue Act of 1921 any tax paid by a corporation pursuant to a tax-free covenant clause need not be included in the gross income of the obligee.

ART. 566. Tax on bank or other stock.—Under the Revenue Act of 1921 banks or other corporations paying taxes assessed against their

stockholders on account of their ownership of the shares of stock issued by such corporations, without reimbursement from such shareholder or member, may deduct the amount of taxes so paid. The statute specifically provides, however, that in such cases the stockholders may not deduct the amount of the taxes.

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.—For the calendar year 1921 insurance companies (other than life 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. After December 31, 1921, such insurance companies, except mutual companies, are entitled only to the deductions allowed by section 247. See article 693. Mutual insurance companies (other than life) are not entitled to the deductions allowed by section 247, but are entitled to the deductions allowed by section 234. See articles 569-572. "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. For deductions allowed life insurance companies see section 245 and articles 681-687.

ART. 569. Required addition to reserve funds of insurance companies.—This article applies to all insurance companies (except life) for the calendar year 1921; thereafter it applies only to mutual 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 guaranty 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. 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. This article does not apply to life insurance companies taxed under section 243 nor to any taxable period after December 31, 1921.

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 such insurance companies and other corporations.

ARR. 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. The proper apportionment and allocation of the deductions with respect to sources within and without the United States shall be determined as provided in section 217 and articles 325-328.

ITEMS NOT DEDUCTIBLE BY CORPORATIONS.

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 per-

manent 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 291-295.

ART. 582. Capital expenditures.—Expenses of the organization of a corporation, such as incorporation fees, attorneys' and accountants' charges, are ordinarily capital expenditures, but where such expenditures are limited to purely incidental expenses, a taxpayer may charge such items against income in the year in which they are incurred. 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 CORPORATIONS.

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) In the case of a domestic corporation the net income of which is \$25,000 or less, a specific credit of \$2,000; but if the net income is more than \$25,000 the tax imposed by section 230 shall not exceed the tax which would be payable if the \$2,000 credit were allowed, plus the amount of the net income in excess of \$25,000; and

(c) The amount of any war-profits and excess-profits taxes imposed by Act of Congress for the same taxable year. The credit allowed by this subdivision shall be determined as follows:

(1) In the case of a corporation which makes return for a fiscal year beginning in 1920 and ending in 1921, in computing the income tax as provided in subdivision (a) of section 205, the portion of the war-profits and excess-profits tax computed for the entire period under clause (1) of subdivision (a) of section 335 shall be credited against the net income computed for the entire period as provided in clause (1) of subdivision (a) of section 205, and the portion of the war-profits and excess-profits tax computed for the entire period under clause (2) of subdivision (a) of section 335 shall be credited against the net income computed for the entire period as provided in clause (2) of subdivision (a) of section 205.

(2) In the case of a corporation which makes return for a fiscal year beginning in 1921 and ending in 1922, in computing the income

tax as provided in subdivision (b) of section 205, the war-profits and excess-profits tax computed under subdivision (b) of section 335 shall be credited against the net income computed for the entire period as provided in clause (1) of subdivision (b) of section 205.

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 (only if its net income is \$25,000 or less), plus the amount of any war profits and excess profits tax assessed or to be assessed for the same taxable year (in case of fiscal years ending in 1921 and 1922, see sec. 205 and arts. 1623–1624), 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 77–83. 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 credit provided in subdivision (c) of section 236 but not the credit of \$2,000. The statute repeals the war profits and excess profits tax as of January 1, 1922. For the purpose of the war profits and excess profits tax a corporation is not entitled to the credits mentioned in this article. To lessen the inequality between the tax upon net income of \$25,000 and upon net income slightly in excess of that amount, subdivision (b), section 236, provides that the tax shall not exceed the tax which would be payable if the \$2,000 credit were allowed, plus the amount of the net income in excess of \$25,000. As to the equalizing provision in the case of individual incomes slightly in excess of \$5,000, see section 216 (c), and article 301.

PAYMENT OF CORPORATION INCOME 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 12½ per centum thereof (but during the calendar year 1921 only 10 per centum), 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 12½ per cent (10 per cent during the calendar year 1921) in the case of other fixed or determinable annual or periodical income, other than corporate dividends. See section 221 of the statute and articles 361-375. 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, Form 1086, 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 IN CASE OF CORPORATIONS.

Sec. 238. (a) That in the case of a domestic corporation the tax imposed by this title, plus the war-profits and excess-profits taxes, if any, shall be credited with the amount of any income, war-profits, and excess-profits taxes paid during the same taxable year to any foreign country, or to any possession of the United States: *Provided*, That the amount of credit taken under this subdivision shall in no case exceed the same proportion of the taxes, against which such credit is taken, which the taxpayer's net income (computed without deduction for any income, war-profits, and excess-profits taxes imposed by any foreign country or possession of the United States) from sources without the United States bears to its entire net income (computed without such deduction) for the same taxable year. In the case of domestic insurance companies subject to the tax imposed by section 243 or 246, the term "net income," as used in this subdivision means net income as defined in sections 245 and 246, respectively.

(b) 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 income, war-profits and excess-profits taxes 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.

(c) These credits shall be allowed only if the taxpayer furnishes evidence satisfactory to the Commissioner showing the amount of income derived from sources without the United States, and all other information necessary for the verification and computation of such credit.

(d) If a domestic corporation makes a return for a fiscal year beginning in 1920 and ending in 1921, the credit for the entire fiscal year shall, notwithstanding any provision of this Act, be determined under the provisions of this section; and the Commissioner is authorized to disallow, in whole or in part, any such credit which he finds has already been taken by the taxpayer.

(e) For the purposes of this section a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends (not deductible under section 234) in any taxable year shall be deemed to have paid the same proportion of any income, war-profits, or excess-profits taxes paid by such foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits: *Provided*, That the credit allowed to any domestic corporation under this subdivision shall in no case exceed the same proportion of the taxes against which it is credited, which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included. The term "accumulated profits" when used in this subdivision in reference to a foreign corporation, means the amount of its gains, profits, or income in excess of the income, war-profits, and excess-profits taxes imposed upon or with respect to such profits or income; and the Commissioner with the approval of the Secretary shall have full power to determine from the accumulated profits of what year or years such dividends were paid; treating dividends paid in the first sixty days of any year as having been paid from the accumulated profits of the preceding year or years (unless to his satisfaction shown otherwise), and in other respects treating dividends as having been paid from the most recently accumulated gains, profits, or earnings. In the case of a foreign corporation, the income, war-profits, and excess-profits taxes of which are determined on the basis of an accounting period of less than one year, the word "year" as used in this subdivision shall be construed to mean such accounting period.

(f) For the purposes of this section a corporation entitled to the benefits of section 262 shall be treated as a foreign corporation.

Art. 611. Credit for foreign taxes.—This credit includes income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States but shall not exceed the same proportion of the taxes against which the credit is taken which the taxpayer's net income (computed without deduction for any income, war profits, and excess profits taxes imposed by any foreign country or possession of the United States) from sources without the United States bears to its entire net income (computed without such deduction). If the return is for a fiscal year beginning in 1920 and ending in 1921 the credit shall be determined entirely under the Revenue Act of 1921 instead of partly under the Revenue Act of 1918 and partly under the later statute. 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 612. A claim for credit in such a case is also to be made on Form 1118. For the meaning of the terms used in section 238 of the statute see section 2 and article 382.

As to the meaning of net income in the case of domestic life insurance companies, see articles 671-686, and in the case of other domestic insurance companies (except mutual) after December 31, 1921, see articles 691-693.

ART. 612. Domestic corporation owning a majority of the stock of foreign corporation.—A domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends (not deductible under section 234) in any taxable year, shall be entitled to credit against the amount of its income, war profits or excess profits taxes, the same proportion of the sum of any income, war profits or excess profits taxes paid or accrued by such foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such corporation from which such dividends were paid, which the amount of any such dividends received bears to the amount of such accumulated profits. But in no case shall such credit exceed the same proportion of the taxes against which it is credited, which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included. 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.

For the purposes of section 238 a corporation entitled to the benefits of section 262 is treated as a foreign corporation.

CORPORATION RETURNS.

Sec. 239. (a) 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.

(b) 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 (b) 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.

(c) There shall be included in the return or appended thereto a statement of such facts as will enable the Commissioner to determine the portion of the earnings or profits of the corporation (including gains, profits and income not taxed) accumulated during the taxable year for which the return is made, which have been distributed or ordered to be distributed, respectively, to its stockholders or members during such year.

ART. 621. Corporation returns.—Every corporation not expressly exempt from tax 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 article 632. 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 1921 prior to the enactment of the present statute is not relieved from the necessity of rendering returns thereunder for such portion of 1921 as elapsed before its dissolution. Section 239 (c) requires every corporation to include in its return a statement of such facts as will enable the Commissioner to determine the portion of the earnings, including gains, profits, and income not taxed, accumulated during the taxable year which have been distributed or ordered to be distributed, respectively, to its stockholders during such year. 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 548.

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, except that life insurance companies shall make return on Form 1120L. 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. 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 year of its stockholders. See sections 200, 212, and 218 of the statute, and articles 1523–1532, 25, 26, and 336–339. For the calendar year 1921 the return shall be made on Form 1065. If the personal service corporation makes any change in its accounting period, it shall render the return in accordance with the provisions of section 226 of the statute and article 431. The return of a personal service corporation covering any period beginning prior to January 1, 1922, should 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 amounts 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 and the names of the distributees; (f) the names and addresses of the stockholders of the corporation and their respective shares in such corporation at the close of its taxable year, and on December 31, 1921; (g) such facts as tend to show whether or not the corporation is a personal service corporation with reference to any period beginning prior to January 1, 1922; and (h) such other facts as are required by the form. Earnings attributable to the calendar year 1922 and subsequent years are taxed to the personal service corporation in the same manner as the earnings of ordinary corporations are taxed. In the case of a corporation rendering personal service, affiliated with one or more corporations in which capital is a material factor in producing income, see sections 200, 240, and 303 of the statute, and articles 1524, 632-633, and 741-743. For the calendar year 1922, returns should be made on Form 1120. See article 621. Relative to the report of income in the case of a personal service corporation having a fiscal year ending in 1922, see article 337.

ART. 625. Returns of foreign corporations.—Every foreign corporation and corporation satisfying the conditions set forth under section 262, 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 for only a part of the calendar 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 having a net income not exceeding \$25,000 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. This prorated credit shall be applied to the net income before such net income is placed on an annual basis, as provided in section 226(c). See sections 236 and 305 and articles 591 and 761.

CONSOLIDATED RETURNS OF CORPORATIONS.

Sec. 240. (a) That corporations which are affiliated within the meaning of this section may, for any taxable year beginning on or after January 1, 1922, make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return. If return is made on either of such bases, all returns thereafter made shall be upon the same basis unless permission to change the basis is granted by the Commissioner.

(b) 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 computed as provided in subdivision (b) of section 236.

(c) 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.

(d) For the purposes of this section a corporation entitled to the benefits of section 262 shall be treated as a foreign corporation: *Provided*, That in any case of two or more related trades or businesses (whether unincorporated or incorporated and whether organized in the United States or not) owned or controlled directly or indirectly by the same interests, the Commissioner may consolidate the accounts of such related trades and businesses, in any proper case, for the purpose of making an accurate distribution or apportionment of gains, profits, income, deductions, or capital between or among such related trades or businesses.

(e) Corporations which are affiliated within the meaning of this section shall make consolidated returns for any taxable year beginning prior to January 1, 1922, in the same manner and subject to the same conditions as provided by the Revenue Act of 1918.

ART. 631. Affiliated corporations.—Consolidated returns are based upon the principle of levying the tax according to the true net income and invested capital of a single enterprise, even though the business is operated through more than one corporation. Where one corporation owns or controls 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.

ART. 632. Consolidated returns.—Affiliated corporations, as defined in the statute and in article 633, for a taxable period beginning prior to January 1, 1922, are required to file consolidated returns, and for a taxable period beginning on or after January 1, 1922, may elect to file such returns. The return for the first taxable period beginning on or after January 1, 1922, may be made either upon a consolidated basis or as separate corporations, regardless of the manner in which returns for previous years were filed, but an election so made shall be binding upon the taxpayer as to the manner of reporting for subsequent years, unless express permission is obtained from the Commissioner to make a change in the method of reporting. In applying for permission to make such change the taxpayer should submit a statement in the form of an affidavit executed by a person qualified to sign the return (see sec. 239), setting forth the reasons for making the request.

The consolidated return shall be filed on Form 1120 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 for the first time shall include in such return a statement 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, partnerships, or corporations constituting such interests, with the percentage of the total outstanding stock of each affiliated corporation held by each of such individuals, partnerships, or corporations during all or any part 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. If there are substantial changes of ownership during the taxable year, the information required under (b) and (c) above should show the conditions existing immediately subsequent to such changes.

In the case of a taxable period beginning prior to January 1, 1922, where two or more corporations are affiliated within the meaning of this section, if the business of any one or more of the corporations taken independently is such as to entitle it to classification as a personal service corporation, and the business of one or more of the corporations is such that it would not be so entitled, all the affiliated corporations shall be consolidated and the corporations of the former

class shall lose their status as personal service corporations. If the business of the consolidated group as a whole is such that it meets the requirements of section 303, the tax shall be computed under the provisions of that section; provided, however, that if the income of the consolidated group is to be ascribed primarily to the activities of the principal owners or stockholders, and if the affairs of each affiliated corporation are actively and regularly conducted by the owners or stockholders of the consolidated group, and if capital (whether invested or borrowed), is not a material factor in producing the income of the consolidated group, the consolidated group may be treated as a personal service corporation. See sections 200 and 218 and articles 1523-1532 and 336-339.

Foreign corporations and corporations entitled to the benefits of section 262 may not file consolidated returns; but see article 637.

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 for any taxable year beginning prior to January 1, 1922, 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 70 per cent, a full disclosure of the 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. This information will also be required where like conditions exist and the taxpayer elects to file a consolidated return for any taxable period beginning on or after January 1, 1922. Such statement should preferably be made in advance of filing the return, but if a consolidated return is filed subject to the approval of the Commissioner, the required statement should be filed as a part of the return. The words “the same interests” shall be deemed to mean the same individual, partnership, or corporation, or the same individuals, partnerships, or corporations, but when the stock of two or more corporations is owned or controlled by two or more individuals, by two or more partnerships, or by two or more corporations, the corporations will not be held to be affiliated unless the percentage

of stock of such corporations held by each individual, each partnership, or each corporation is substantially the same in each of the corporations.

ART. 634. Change in ownership during taxable year.—(a) Where corporations are affiliated at the beginning of a taxable year but due to a change in stock ownership or control during the year the affiliated status is terminated, or (b) where corporations are not affiliated at the beginning of the taxable year but through change of stock ownership or control during the year become affiliated, a full disclosure of the circumstances of such changes of stock ownership shall be submitted to the Commissioner. Ordinarily in such cases the parent or principal company, under the conditions described in (a) above, should exclude from its return the income and invested capital of such subsidiary or subordinate company from the date of the change of stock ownership, and under the conditions described in (b) above, should include in its return the income and invested capital of such subsidiary or subordinate company from the date of the change of stock ownership. In either case the subsidiary or subordinate corporation whose status is changed during the taxable year should make a separate return for that part of the taxable year during which it was outside of the affiliated group.

Where, in accordance with the procedure set forth above, a return is made by a corporation for a period less than a year, the tax shall be computed in accordance with sections 226 and 239 and the articles thereunder. In any case in which the change of consolidated status is for a period so short as to be negligible, a consolidated return or separate returns for the entire period, as the case may be, may be filed; in such cases, however, there should accompany the return a complete statement setting forth the changes in the affiliated status occurring during the taxable year.

ART. 635. Domestic corporation affiliated with foreign corporation.—A domestic corporation which owns a majority of the stock of a foreign corporation or of a corporation entitled to the benefits of section 262 shall not be permitted or required to include the net income or invested capital of such corporation in a consolidated return; but see article 637 regarding related trades or businesses owned or controlled by the same interests, as comprehended by section 240 (d). See subdivision (e) of section 238 and article 612 regarding credit for taxes on account of ownership of stocks of foreign corporations and of corporations entitled to the benefits of section 262.

ART. 636. 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 (whether or not resulting in any profit or

loss to the separate corporations), the consolidated taxable net income shall be the combined net income of the several corporations consolidated. Only one specific credit of \$2,000, as provided in section 236 (b) and article 591, shall be allowed the consolidated group, and this only in case the net income of the group does not exceed \$25,000; but if such net income is more than \$25,000, the tax imposed by section 230 shall not exceed the tax which would be payable if the \$2,000 were allowed, plus the amount of the net income in excess of \$25,000. 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. 637. Consolidated accounts of related trades owned by same interests.—Subdivision (d) of section 240 provides that in any case of two or more related trades or businesses (whether incorporated or not, and whether organized in the United States or not), owned or controlled directly or indirectly by the same interests, the Commissioner may consolidate the accounts of such related trades or businesses, in any proper case, for the purpose of making an accurate distribution or apportionment of gains, profits, income, deductions, or capital between or among such related trades or businesses. This provision relates not to the *payment* of taxes, but to the determination of the true income of related trades or businesses and thus indirectly to the *amount* of taxes which may be due under Title II and Title III of the statute.

ART. 638. Different fiscal years of affiliated corporations.—In the case of all consolidated returns for taxable years beginning prior to January 1, 1922, consolidated invested capital must be computed as of the beginning of the taxable year of the parent or principal reporting corporation and consolidated income must be computed on the basis of its taxable year. If a consolidated return is made for any taxable year beginning on or after January 1, 1922, consolidated income must be computed on the basis of the taxable year of the parent or principal reporting corporation. 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 corporation. See section 226 of the statute and article 431.

TIME AND PLACE FOR FILING CORPORATE RETURNS.

SEC. 241. (a) That returns of corporations shall be made at the same time as is provided in subdivision (a) of section 227, except that in the case of foreign corporations not having any office or place of business in the United States returns shall be made at the same time as provided in section 227 in the case of a nonresident alien individual.

(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. In the case of foreign corporations not having any office or place of business in the United States, however, returns shall be made on or before the fifteenth day of the sixth month following the close of the fiscal year, or, if the return is made on the basis of the calendar year, then, on or before June 15. 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 1055.

TAX ON LIFE INSURANCE COMPANIES.

SEC. 242. That when used in this title the term “life insurance company” means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

SEC. 243. That in lieu of the taxes imposed by sections 230 and 1000 and by Title III, there shall be levied, collected, and paid for the calendar year 1921 and for each taxable year thereafter upon the net income of every life insurance company a tax as follows:

(1) In the case of a domestic life insurance company, the same percentage of its net income as is imposed upon other corporations by section 230;

(2) In the case of a foreign life insurance company, the same percentage of its net income from sources within the United States as is imposed upon the net income of other corporations by section 230.

ART. 661. **Life insurance companies.**—For the calendar year 1921 and thereafter, life insurance companies, as defined in section 242,

shall pay the tax imposed by section 243, in lieu of the taxes imposed by sections 230 and 1000 and by Title III of the statute. The rate for 1921 is 10 per cent and for subsequent years $12\frac{1}{2}$ per cent, as in the case of other corporations, but the net income upon which the tax is imposed differs from the net income of other corporations. Insurance companies are entitled to the benefit of section 204 (net losses) but not of section 206 (capital net gain). All provisions of the statute and of these regulations not inconsistent with the specific provisions of sections 242 to 245, inclusive, are applicable to the assessment and collection of this tax, and life insurance companies are subject to the same penalties as provided in the case of returns and payment of income tax by other corporations. In determining whether an insurance company is a "life insurance company" as defined in section 242, no reserve shall be regarded as held for the fulfillment of life insurance and annuity contracts unless the company is entitled to a deduction from gross income on account thereof under the provisions of section 245(a) (2) and article 681. As to foreign companies see section 245(c) and article 687.

SEC. 244. (a) That in the case of a life insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents.

(b) The term "reserve funds required by law" includes, in the case of assessment insurance, sums actually deposited by any company or association with State or Territorial officers pursuant to law as guaranty or reserve funds, and any funds maintained under the charter or articles of incorporation of the company or association exclusively for the payment of claims arising under certificates of membership or policies issued upon the assessment plan and not subject to any other use.

ART. 671. **Gross income of life insurance companies.**—Net income in the case of life insurance companies is gross income from interest, dividends and rents less the deductions allowed by section 245. Gross income comprises items 25–34, inclusive, of the income page of the annual statement for life companies (edition of 1920) adopted by the National Convention of Insurance Commissioners and items 23–30, inclusive, of the income page of the annual statement for miscellaneous stock companies if any other branches of the insurance business are conducted by the company; except that the rental value of the space occupied by the company in its own building or buildings if included in gross income shall be determined according to the provisions of section 245(b) and article 686. As to "reserve funds required by law," see article 681.

SEC. 245. (a) That in the case of a life insurance company the term "net income" means the gross income less—

(1) The amount of interest received during the taxable year which under paragraph (4) of subdivision (b) of section 213 is exempt from taxation under this title:

(2) An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life insurance companies 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) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

(3) The amount received as dividends (A) from a domestic corporation other than a corporation entitled to the benefits of section 262, or (B) from any foreign corporation when it is shown to the satisfaction of the Commissioner that more than 50 per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the foreign corporation has been in existence) was derived from sources within the United States as determined under section 217;

(4) An amount equal to 2 per centum of any sums held at the end of the taxable year as a reserve for dividends (other than dividends payable during the year following the taxable year) the payment of which is deferred for a period of not less than five years from the date of the policy contract;

(5) Investment expenses paid during the taxable year: *Provided*, That if any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year;

(6) Taxes and other expenses paid during the taxable year exclusively upon or with respect to the real estate owned by the company, not including taxes assessed against local benefits of a kind tending to increase the value of the property assessed, and not including any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. The deduction allowed by this paragraph shall be allowed in the case of taxes imposed upon a shareholder or member of a company upon his interest as shareholder or member, which are paid by the company without reimbursement from the shareholder or member, but in such cases no deduction shall be allowed the shareholder or member for the amount of such taxes;

(7) A reasonable allowance for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence. In the case of property acquired before March 1, 1913, this deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913;

(8) 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, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title;

(9) In the case of a domestic life insurance company, the net income of which (computed without the benefit of this paragraph) is \$25,000 or less, the sum of \$2,000; but if the net income is more than \$25,000 the tax imposed by section 243 shall not exceed the tax which would be payable if the \$2,000 credit were allowed, plus the amount of the net income in excess of \$25,000.

(b) No deduction shall be made under paragraphs (6) and (7) of subdivision (a) on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied.

(c) In the case of a foreign life insurance company the amount of its net income for any taxable year from sources within the United States shall be the same proportion of its net income for the taxable year from sources within and without the United States, which the reserve funds required by law and held by it at the end of the taxable year upon business transacted within the United States is of the reserve funds held by it at the end of the taxable year upon all business transacted.

ART. 681. Reserve funds.—Under paragraphs (1) and (2) of section 245(a), life insurance companies are entitled to deduct from gross income: (1) Interest which is exempted in the case of other taxpayers by section 213(b)(4) and articles 74–83; and (2) the excess, if any, of the reserve deduction specified in section 245(a)(2) over the amount of such interest. The reserve deduction is based upon the reserves required by express statutory provisions or by the rules and regulations of the State insurance departments when promulgated in the exercise of a power conferred by statute; but such reserves do not include assets required to be held for the ordinary running expenses of the business nor do they include the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance. In the case of life insurance companies 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, it is required that reserves thereon be based upon recognized tables of experience covering disability benefits of the kind contained in policies issued by this particular class of companies. Only reserves peculiar to insurance companies are to be taken into consideration. Reserves “maintained to provide for the ordinary running expenses of a business, definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance and unpaid brokerage” (*Maryland Casualty Co. v. United States*, 251 U. S., 342), will not be considered.

A company is permitted to make use of the highest aggregate reserve called for by any State in which it transacts business, but the reserve must have been actually held as shown by the annual statement. Generally speaking, the following will be considered reserves as contemplated by the law: Items 7, 8, 9, 10, and 11 of the liability page of the annual statement for life companies, and items 16, 17, 18, 19, and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business. If other reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the State statute or insurance department ruling requiring that such reserves be held.

ART. 682. Reserve for deferred dividends.—The deduction for deferred dividends under section 245 (a) (4) will be based upon item 37 of the liability page of the annual statement for life companies but shall not include any dividend payable during the year immediately following the taxable year.

ART. 683. Investment expenses.—If any general expenses are in part assigned to or included in the investment expenses, the total investment expenses (other than taxes and expenses with respect to real estate) allowable as a deduction shall not exceed one-quarter of 1 per cent of the mean of the book value of the invested assets held at the beginning and end of the taxable year. If there be no allocation of general expenses to investment expenses the deduction may consist of investment expenses actually paid during the taxable year, in which case an itemized schedule of such expenses must be appended to the return. The invested assets are items 1–6, inclusive, item 9, and items 10 and 11 (if interest-bearing assets) of the asset page of the annual statement for life companies, and items 1–4, inclusive, item 7, and items 27–30, inclusive (if interest-bearing assets), of the asset page of the annual statement for miscellaneous stock companies. If the method used by any company in ascertaining the investment expenses where there is any allocation of general expenses shall be changed so that a greater deduction is claimed, the company shall file with its return, information sufficient to enable the Commissioner to determine the validity of the claim. The maximum allowance of one-quarter of 1 per cent will not be granted unless it is shown to the satisfaction of the Commissioner that such allowance is justified.

ART. 684. Taxes and expenses with respect to real estate.—This deduction comprises items 31 and 32 of the disbursement page of the annual statement for life companies and items 34 and 35 of the disbursement page of the annual statement for miscellaneous stock companies, except as noted below, and any sum included in any

other item representing taxes imposed upon the individual shareholders' or members' interest in the real estate of the corporation which is paid by the corporation without reimbursement from the individual shareholder or member. In the latter case the amount allowable as a deduction (subject to the provisions of art. 686) shall be that proportion of the total tax imposed upon the individual shareholders' or members' interest in the corporation which the book value of the real estate owned by the corporation at the end of the taxable year is of the book value of all the corporation's ledger assets, and so much thereof as represents the tax upon real estate occupied in whole or in part by the company must be included in the calculation referred to in article 686. The amount so included shall be that proportion of the total amount allowable as a deduction which the book value of the real estate owned and occupied in whole or in part is of the book value of all the real estate owned. Full details must accompany the return. Any other taxes and expenses (and depreciation) upon any real estate owned and occupied in whole or in part by the company must also be included in the calculation referred to in article 686. Taxes shall not include assessments against local benefits of a kind tending to increase the value of the property assessed and expenses shall not include any amount paid out for buildings or for permanent improvements and betterments made to increase the value of any property.

ART. 685. Other deductions.—(1) The deduction allowed by section 245 (a) (3) for dividends received from other corporations is identical with the deduction allowed other corporations by section 234 (a) (6). See article 561.

(2) The deduction allowed by section 245 (a) (7) for depreciation is identical with that allowed other corporations by section 234 (a) (7). See articles 561, and 161-171.

(3) The deduction allowed by section 245 (a) (8) for interest on indebtedness is the same as that allowed corporations by section 234 (a) (2) (see arts. 561, 121, and 122), but this deduction includes item 18 of the disbursement page of the annual statement of life companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein.

(4) The deduction of \$2,000 allowed domestic life insurance companies with net income of \$25,000 or less by section 245 (a) (9) is identical with the specific credit allowed other corporations by section 236 (b) and there is the same equalizing provision in the case of incomes slightly in excess of \$25,000. See article 591.

ART. 686. Home office properties.—No deduction shall be made for any taxes, expenses, or depreciation on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the return of gross income the ren-

tal value of the space so occupied. Such rental value shall not be less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and other expenses) at the rate of 4 per cent per annum of the book value at the end of the taxable year of the real estate so owned and occupied. For example, if the book value of a parcel of real estate owned and occupied in whole or in part by the company is \$1,000,000, the rents received from other tenants \$30,000, taxes and expenses \$40,000, and depreciation \$20,000, the company would have to include in its gross income a sum not less than \$70,000 (\$40,000 taxes and expenses, plus \$20,000 depreciation, minus \$30,000 rents from tenants, plus 4 per cent of \$1,000,000) as the rental value of the space occupied by it in order to avail itself of the deductions of \$40,000 and \$20,000. In any case the rents received from other tenants must be included in gross income.

ART. 687. Foreign companies.—Foreign life insurance companies holding reserve funds upon business transacted within the United States are taxed under section 243 upon their net income from sources within the United States. All business transacted by a United States branch or agency of a foreign insurance company, for which a reserve fund is required by the laws of any State or Territory of the United States or of the District of Columbia, will be regarded as business transacted within the United States. A foreign life insurance company not doing an insurance business within the United States and holding no reserve funds upon business transacted within the United States, but which derives income from sources within the United States as defined in section 217 (see arts. 316–329) is subject to the tax imposed by section 230 upon income derived from sources within the United States. See articles 501 and 550. As to taxation of life insurance companies between United States and Porto Rico and Philippine Islands, see article 1133.

INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL COMPANIES.

SEC. 246. (a) That, in lieu of the taxes imposed by sections 230 and 1000, there shall be levied, collected, and paid for the calendar year 1922, and for each taxable year thereafter, upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:

(1) In the case of such a domestic insurance company the same percentage of its net income as is imposed upon other corporations by section 230;

(2) In the case of such a foreign insurance company the same percentage of its net income from sources within the United States as is imposed upon the net income of other corporations by section 230.

(b) In the case of an insurance company subject to the tax imposed by this section—

(1) The term "gross income" means the combined gross amount, earned during the taxable year, from investment income and from underwriting income as provided in this subdivision, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners;

(2) The term "net income" means the gross income as defined in paragraph (1) of this subdivision less the deductions allowed by section 247;

(3) The term "investment income" means the gross amount of income earned during the taxable year from interest, dividends and rents, computed as follows:

To all interest, dividends and rents received during the taxable year, add interest, dividends and rents due and accrued at the end of the taxable year, and deduct all interest, dividends and rents due and accrued at the end of the preceding taxable year;

(4) The term "underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;

(5) The term "premiums earned on insurance contracts during the taxable year" means an amount computed as follows:

From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year;

(6) The term "losses incurred" means losses incurred during the taxable year on insurance contracts, computed as follows:

To losses paid during the taxable year, add salvage and reinsurance recoverable outstanding at the end of the preceding taxable year, and deduct salvage and reinsurance recoverable outstanding at the end of the taxable year. To the result so obtained add all unpaid losses outstanding at the end of the taxable year and deduct unpaid losses outstanding at the end of the preceding taxable year;

(7) The term "expenses incurred" means all expenses shown on the annual statement approved by the National Convention of Insurance Commissioners and shall be computed as follows:

To all expenses paid during the taxable year add expenses unpaid at the end of the taxable year and deduct expenses unpaid at the end of the preceding taxable year. For the purpose of computing the net income subject to the tax imposed by this section there shall be deducted from expenses incurred as defined in this paragraph all expenses incurred which are not allowed as deductions by section 247.

Sec. 247. (a) That in computing the net income of an insurance company subject to the tax imposed by section 246 there shall be allowed as deductions:

(1) All ordinary and necessary expenses incurred, as provided in paragraph (1) of subdivision (a) of section 234;

(2) All interest as provided in paragraph (2) of subdivision (a) of section 234;

(3) Taxes as provided in paragraph (3) of subdivision (a) of section 234;

(4) Losses incurred;

(5) Bad debts in the nature of agency balances and bills receivable ascertained to be worthless and charged off within the taxable year;

(6) The amount received as dividends from corporations as provided in paragraph (6) of subdivision (a) of section 234;

(7) The amount of interest earned during the taxable year which under paragraph (4) of subdivision (b) of section 213 is exempt from taxation under this title, and the amount of interest allowed as a credit under subdivision (a) of section 236;

(8) A reasonable allowance, for the exhaustion, wear and tear of property, as provided in paragraph (7) of subdivision (a) of section 234;

(9) In the case of such a domestic insurance company, the net income of which (computed without the benefit of this paragraph) is \$25,000 or less, the sum of \$2,000; but if the net income is more than \$25,000 the tax imposed by section 246 shall not exceed the tax which would be payable if the \$2,000 credit were allowed, plus the amount of the net income in excess of \$25,000.

(b) In the case of a foreign corporation the deductions allowed in this section shall be allowed to the extent provided in subdivision (b) of section 234.

(c) Nothing in this section or in section 246 shall be construed to permit the same item to be twice deducted.

ART. 691. Tax on insurance companies.—For the calendar year 1921 all insurance companies (other than life) are subject to taxes imposed by sections 230 (corporation income tax) and 1000 (capital stock tax) and Title III (war profits and excess profits tax). For the calendar year 1922 and thereafter, however, in lieu of such taxes, insurance companies, except life and mutual companies, are subject to the tax imposed by section 246. Mutual insurance companies (other than life) remain subject to the taxes imposed by sections 230 and 1000. In articles 691–693 the term “insurance companies” means only those companies subject to the tax imposed by section 246. The rate of the tax imposed by section 246 is the same as the rate imposed by section 230 ($12\frac{1}{2}$ per cent), but the net income upon which the tax is imposed, as defined in sections 246 and 247, differs from the net income of other corporations. Insurance companies are entitled to the benefit of section 204 (net losses) but not of section 206 (capital net gain). All provisions of the statute and of these regulations not inconsistent with the specific provisions of sections 246 and 247 are applicable to the assessment and collection of this tax, and insurance companies are subject to the same penalties as provided in the case of returns and payment of income tax by other corporations. Since section 246 provides that the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners shall be the basis for com-

puting gross income and since the annual statement is rendered on the calendar year basis, the first returns under section 246 will be for the taxable year ending December 31, 1922, and will be made on or before March 15, 1923.

ART. 692. Gross income of insurance companies.—Net income is gross income as defined in section 246 less the deductions allowed in section 247. Gross income is the combined gross amount earned during the taxable year from interest, dividends, rents, and premium income, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners. Gross income does not include gain derived from sale or disposition of capital assets, nor are losses sustained from such sale or disposition allowable deductions. It does not include increase in liabilities during the year on account of reinsurance treaties; remittances from home office of a foreign insurance company to United States branch; borrowed money; gross profit on maturity of capital assets; gross increase due to adjustments in book value of capital assets and premium on capital stock sold. The underwriting and investment exhibit is presumed clearly to reflect the true net income of the company, and in so far as it is not inconsistent with the provisions of the statute will be recognized and used as a basis for that purpose. All items of the exhibit, however, do not reflect an insurance company's income as defined in the statute. By reason of the definition of investment income, profit or loss on investment items is ignored, as well as those miscellaneous items which are intended to reflect surplus but do not properly enter into the computation of income, such as dividends declared, home office remittances and receipts, and special deposits. Gain or loss from agency balances and bills receivable not admitted as assets on the underwriting and investment exhibit will be ignored, excepting only such agency balances and bills receivable as have been charged off the books of the company as bad debts, or having been previously charged off and recovered during the taxable year.

ART. 693. Deductions allowed insurance companies.—Insurance companies are entitled to the deductions specified in section 247. The deduction of \$2,000 allowed domestic companies with net income not exceeding \$25,000 is identical with the specific credit allowed other corporations by section 236(b) and there is the same equalizing provision in the case of incomes slightly in excess of \$25,000. See article 591. A domestic insurance company is also entitled to the credit for income, war profits, and excess profits taxes paid during the taxable year to any foreign country or to any possession of the United States which is allowed other domestic corporations by section 238. See article 611. Among the items which may not be

deducted are income and profits taxes, paid or accrued, imposed by the United States and so much of the income and profits taxes imposed by any foreign country or possession of the United States as is allowed as a credit under section 238; taxes assessed against local benefits; donations; decrease during the year due to adjustments in book value of capital assets; decrease in liabilities during the year on account of reinsurance treaties; dividends paid to stockholders; remittances to home office of a foreign insurance company by United States branch; and borrowed money repaid.

PART II B.

TITLE III.—WAR - PROFITS AND EXCESS - PROFITS TAX FOR 1921.

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.

Arr. 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 III of the Revenue Act of 1918, but in addition to the other taxes imposed by this Act, there shall be levied, collected and paid for the calendar year 1921 upon the net income of every corporation (except corporations taxable under subdivision (b) 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.

(b) For the calendar year 1921 there shall be levied, collected, and paid upon the net income of every corporation which derives in such 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) of section 301 of the Revenue Act of 1918, 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 which would be applicable to such

calendar year under the Revenue Act of 1918 if it had been continued in force, shall be used;

(2) Such a portion of a tax computed at the rates specified in subdivision (a) of this section 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.

(c) In any case where the full amount of the excess-profits credit is not allowed under the first bracket of subdivision (a), 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.

ART. 711. Imposition of tax.—The tax is imposed upon the net income attributable to the calendar year 1921, of every corporation, domestic or foreign, except life insurance companies, 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 sec. 2), corporations partly partaking of the nature of personal service corporations (see sec. 303), corporations engaged in the mining of gold (see sec. 304), foreign and abnormal corporations (see sec. 327), reorganized and consolidated corporations (see sec. 331), corporations making their returns upon the basis of a fiscal year (see sec. 335), and corporations which have sold mines or oil or gas wells (see sec. 337). For the requirements as to rendering returns see section 336.

ART. 712. Computation of tax for 1921.—For the calendar year 1921, (a) if the net income, as defined in section 320 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. 713. Computation of tax on income from Government contracts.—In the case of a corporation which derives in the calendar year 1921

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 the sum of the following: (1) Such a proportion of a tax computed at the rates for 1918, specified in subdivision (a) of section 301 of the Revenue Act of 1918, as the portion of the net income attributable to the Government contracts bears to the entire net income, and (2) such a proportion of a tax computed at the rates for 1921, specified in section 301(a) of the Revenue Act of 1921, as the amount of the remaining net income bears to the entire net income. In computing the tax under (1), however, the excess profits credit and the war profits credit which would have been applicable to the calendar year 1921 under the Revenue Act of 1918, if it had been continued in force, 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 2 and article 1510.

ART. 714. 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 directly apportioned) against gross income from the respective sources upon a reasonable basis that will assign to each source a proper proportion of such deductions. 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. 715. Illustration of computation of tax.—A corporation has an invested capital for calendar year 1921 of \$110,000 and a net income of \$40,000.

The excess profits credit is a specific exemption of \$3,000, plus 8 per cent of the invested capital for taxable year (i. e., 8 per cent of \$110,000) or \$8,800, making a total of \$11,800. See section 312 of the statute and article 791.

First bracket: The amount or portion of the net income (\$40,000) 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 (\$40,000) in excess of 20 per cent of the invested capital (i. e., 20 per cent of

\$110,000) is \$18,000. The tax computed under this bracket is 40 per cent of this amount (i. e., 40 per cent of \$18,000) or \$7,200.

Total tax: The total excess profits tax is the sum of the taxes computed under the two brackets (i. e., \$2,040 plus \$7,200) or \$9,240.

ART. 716. Illustration of computation where net income derived from Government contract.—A corporation has an average prewar invested capital of \$60,000; an average prewar net income of \$10,000; a net income for calendar year 1921 of \$40,000 which includes \$15,000 of net income from Government contracts and an invested capital for calendar year 1921 of \$110,000. The tax for calendar year 1921 will be the sum of the amounts computed under clauses (1) and (2) of section 301(b) 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 \$50,000 (the difference in invested capital) or \$5,000, making a total war profits credit of \$18,000.

First bracket: The amount or portion of the net income (\$40,000) 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 (\$40,000) in excess of 20 per cent of the invested capital (i. e., 20 per cent of \$110,000) or \$22,000, is \$18,000. The tax computed under this bracket is 65 per cent of this amount (65 per cent of \$18,000) or \$11,700.

Third bracket: Eighty per cent of the amount 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 (\$3,060 plus \$11,700) is \$14,760. The tax computed under this bracket is the amount by which \$17,600 exceeds \$14,760, or \$2,840.

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 \$11,700 plus \$2,840) or \$17,600, as the part of the net income attributable to Government contracts (\$15,000) is of the entire net income (\$40,000). This portion of the tax is therefore three-eighths of \$17,600, or \$6,600.

(2) The portion of the tax computed under clause (2) is the same proportion of the total amount computed at the rates for 1921, or \$9,240 (for the details see illustration for 1921 under article 715) as the part of the net income not attributable to Government contracts (\$25,000) is of the entire net income (\$40,000). This portion of the tax is therefore five-eighths of \$9,240, or \$5,775.

(3) The total tax for the year 1921 is the sum of the amounts computed under paragraphs (1) and (2) above (\$6,600 plus \$5,775) or \$12,375.

ART. 717. Illustration of computation where excess profits credit not exhausted under first bracket.—A corporation has an invested capital for calendar year 1921 of \$20,000 and a net income of \$7,000.

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.

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 40 per cent of this amount (i. e., 40 per cent of \$2,400) or \$960.

Total tax: The total excess profits tax for calendar year 1921 would be the sum of the taxes computed under the two brackets (i. e., nothing plus \$960), or \$960, were it not that section 302 provides that the maximum tax shall not, in this case, exceed \$800. See articles 731-733. The total excess profits tax for calendar year 1921 is therefore \$800.

ART. 718. Illustration of computation where return is for period of less than 12 months.—A corporation which has reported on the basis of the fiscal year ending March 31, 1921, later changes to a calendar year basis and files a return covering the nine months from April 1, 1921, to December 31, 1921. It has an invested capital for the nine months ending December 31, 1921, of \$120,000, and a net income for such period of \$50,000. 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. The income is placed on an annual basis in accordance with section 226(c) by multiplying the amount thereof, \$50,000, by 12 and dividing by 9, or \$66,666.67.

First bracket: The amount or portion of the net income (\$66,666.67) in excess of the excess profits credit (\$12,600) and not in excess of 20 per cent of the invested capital (i. e., 20 per cent of \$120,000), or \$24,000, is \$11,400. The tax computed under this bracket is 20 per cent of this amount (i. e., 20 per cent of \$11,400), or \$2,280.

Second bracket: The amount or portion of the net income (\$66,666.67) in excess of 20 per cent of the invested capital (i. e., 20 per cent of \$120,000), or \$24,000, is \$42,666.67. The tax computed under this bracket is 40 per cent of this amount (i. e., 40 per cent of \$42,666.67), or \$17,066.67.

Total tax: Nine-twelfths of the sum of the taxes computed under the two brackets (i. e., \$2,280 plus \$17,066.67), or \$14,510.

LIMITATION OF TAX.

SEC. 302. That the tax imposed by subdivision (a) 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 limitations imposed by section 302 of the Revenue Act of 1918 (upon taxes computed under subdivision (c) of section 301 of that Act) are hereby made applicable to taxes computed under subdivision (b) of section 301 of this Act. Nothing in this section shall be construed in such manner as to increase the tax imposed by section 301 of this Act.

ART. 731. *Limitation of tax.*—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: The tax imposed by subdivision (a) 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 20 per cent of the amount of the net income in excess of \$3,000.

Where net income in excess of \$10,000 is derived during the calendar year 1921 from Government war contracts, the limitations imposed in such a case by the Revenue Act of 1918 are continued in effect by the present statute.

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.

ART. 733. *Illustration of computation of limitation of tax.*—A corporation has an invested capital for calendar year 1921 of \$20,000 and a net income of \$9,000. The excess profits tax computed under section 301 (a) of the statute would be \$1,760. Section 302 provides, however, that the tax under section 301(a) shall not be more than 20 per cent of the net income in excess of \$3,000 and not in excess of \$20,000. In this case the tax must not exceed 20 per cent of \$6,000 (i. e., 20 per cent of the net income in excess of \$3,000) or \$1,200. The tax under section 301(a), amounting to \$1,760, will accordingly be reduced to \$1,200.

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 section 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 714. For the definition of "personal service corporation" see articles 1523-1532.

ART. 742. Computation of tax upon net income.—(1) The tax upon the nonpersonal service part of the net income is computed upon the basis of (a) 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 (b) 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.

(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 nonpersonal 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 711-718 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 nonpersonal 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 invested capital for 1921 of \$100,000 (of which \$81,000 is used in contracting and \$19,000 in engineering); and a net income for 1921 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.

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 20 per cent of this amount (i. e., 20 per cent of \$8,720) or \$1,744.

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 40 per cent of this amount (40 per cent of \$13,800) or \$5,520.

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 two brackets (i. e., \$1,744 plus \$5,520) or \$7,264. This is 24.214 per cent of \$30,000, 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 per-

centage of such part of the net income (i. e., 24.214 per cent of \$60,000) or \$14,528.

(3) The total tax is the sum of \$7,264 (the tax upon the first part of the net income derived from contracting) and \$14,528 (the tax upon the second part of the net income derived from engineering) or \$21,792.

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 his 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 or any tax imposed by Title II of the Revenue Act of 1917, and the tax on the remaining portion of the net income shall be the same 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. Life insurance companies are not subject to the tax. See article 661. 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 the tax imposed by this title and also from the tax imposed by Title II of the Revenue Act of 1917. 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 714.

ART. 753. **Illustration of computation of tax where net income is from gold mining.**—In the case of the corporation used as an illustration in article 715, let it be assumed that it is engaged in the mining both of gold and other rare metals; that the Commissioner finds under article 714 that \$25,000 of its gross income is properly attributable

to the mining of gold; and that \$15,000 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 \$10,000. The remaining portion of the net income is \$30,000, 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 \$9,240) which the remaining portion of the net income (\$30,000) bears to the entire net income (\$40,000). The tax will therefore be three-fourths of the tax of \$9,240 computed without benefit of the exemption, or \$6,930.

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.—Full effect is given to section 305 by placing the income on an annual basis as provided in section 226(c). See articles 718, 855, and 856.

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 or a corporation entitled to the benefits of section 262 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 716–718, 743, and 761.

NET INCOME.

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

ART. 801. Net income.—The net income of a corporation for the purpose of the imposition of the 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.

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 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, 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 can not be included in computing invested capital.

ART. 813. Borrowed capital: amounts left in business.—Whether a given amount paid into or left in the business of a corporation con-

stitutes borrowed capital or paid-in surplus is a question of fact. Thus, indebtedness to stockholders canceled 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 so left with the corporation must be considered as borrowed capital and be so treated in computing invested capital.

ARR. 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.

ARR. 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.

ARR. 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 74–85.

ARR. 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 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 subdivision (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

(b) As used in this title the term "invested capital" does not 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 be the same fractional part of such average invested capital.

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 authori-

ties 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 recognition should 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 has been made good. Where explicit and convincing 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 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 explicit and convincing evidence (and calculations based upon a theoretical formula are not such 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, and in every such case due regard must be given to expenditures made by the taxpayer to maintain the effective usefulness of the property. 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 explicit and convincing 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 municipal 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 usually be permitted, as in such cases where the treatment of the item was optional and the decision made at the time conformed to the best accounting practice, 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 where tangible property has been paid in as a 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 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. 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 incorrectly 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 261-263.

Arr. 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.

Arr. 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.

Arr. 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, 1921, and if \$100,000 of additional capital was paid in on February 17, 1921, 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 $\frac{318}{365}$ of \$100,000, or \$87,123.29. If \$50,000 of this amount was withdrawn on October 31, 1921, the amount to be deducted would be $\frac{62}{365}$ 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 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 for the method of computing the changes in its invested capital made during the period, see article 856. Since in accordance with sections 239 and 226 the income is placed upon a yearly basis, the full average invested capital for the period should be used in computing the tax under this title. See article 718.

ART. 856. Illustration of invested capital for fractional part of year.—A corporation was organized July 1, 1921, and makes a return for the six months ending December 31, 1921. 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 $\frac{92}{184}$ (not $\frac{92}{365}$) of \$100,000, or \$50,000, a total of \$150,000.

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 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 art. 845), and (b) dividends paid after the expiration of the first sixty days of the taxable year (see sec. 201 of the statute and art. 1541) and other corporate purposes, including the purchase of outstanding stock of the corporation previously issued (see art. 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 operating deficit, but where there has been directly or indirectly a liquidation or return of their investment to the stockholders, 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 543.

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 543.

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 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 (c) 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, and 331 of the statute and articles 811-818, 831-869, 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 art. 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. Insurance companies.—The reserve funds of insurance companies (other than life) the net additions to which are deductible from gross income under the provisions of section 234 of the

statute, may be included in computing invested capital. See sections 325 and 326 and articles 569 and 814.

ART. 870. Foreign corporations.—Inasmuch as the excess profits tax in the case of a foreign corporation or of a corporation entitled to the benefits of section 262 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 831–868 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 or of a corporation entitled to the benefits of section 262;

(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.

ARR. 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 2 and 326 and articles 831-870 and 1510.

COMPUTATION OF TAX IN SPECIAL CASES.

Sec. 328. (a) That 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 or of a corporation entitled to the benefits of section 262 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.

(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 character of business, size and condition of plant, 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 or a corporation entitled to the benefits of section 262, where 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 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 or a corporation entitled to the benefits of section 262, 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 can be determined with reasonable accuracy, the installments shall in the first instance be determined upon the basis of an excess profits tax computed by using the minimum invested capital, the tax in any such case 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.

ART. 913. Determination of first installment of tax in the case of foreign corporation or a corporation entitled to the benefits of section 262.—
In the case of a foreign corporation or a corporation entitled to the benefits of section 262 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 the calendar year 1921 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 re-

tained 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 or a corporation entitled to the benefits of section 262 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 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.

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 an 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. 331. That 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 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.

FISCAL YEARS ENDING IN 1921 OR 1922.

SEC. 335. (a) That if a corporation (other than a personal service corporation) makes return for a fiscal year beginning in 1920 and ending in 1921, the war-profits and excess-profits tax for the taxable year 1921 shall be the sum of: (1) the same proportion of a tax for the entire period computed under the Revenue Act of 1918, which the portion of such period falling within the calendar year 1920 is of the entire period, and (2) the same proportion of a tax for the entire period computed under this title, which the portion of such period falling within the calendar year 1921 is of the entire period. Any amount heretofore or hereafter paid on account of the tax imposed for such taxable year by the Revenue Act of 1918 shall be credited towards the payment of the tax as above computed, and if the amount so paid exceeds the amount of such tax, the excess shall be credited or refunded to the corporation in accordance with the provisions of section 252 of this Act.

(b) If a corporation (other than a personal service corporation) makes a return for a fiscal year beginning in 1921 and ending in 1922, the war-profits and excess-profits tax for the portion of the year falling within the calendar year 1921 shall be an amount equivalent to the same proportion of a tax for the entire period computed under this title, which the portion of such period falling within the calendar year 1921 is of the entire period.

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 1621-1624. Subdivision (a), which deals with fiscal years beginning in 1920 and ending in 1921, and subdivision (b), which deals with fiscal years beginning in 1921 and ending in 1922, apply to corporations other than personal service corporations.

ART. 952. **Fiscal year of corporation ending in 1921.**—The method provided for computing the tax for a fiscal year beginning in 1920 and ending in 1921 is as follows: (*a*) The tax attributable to the calendar year 1920 is found by computing the income of the taxpayer and the tax thereon in accordance with the Revenue Act of 1918 as if the fiscal year was the calendar year 1920, and determining the proportion of such tax which the number of months falling within the calendar year 1920 is of the number of months in the entire period; (*b*) the tax attributable to the calendar year 1921 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 1921, and determining the proportion of such tax which the number of months falling within the calendar year 1921 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 1920 and the tax attributable to the calendar year 1921.

ART. 953. Credits in the case of fiscal year ending in 1921.—Amounts previously paid by the taxpayer on account of the excess-profits tax for its fiscal year ending in 1921 shall be credited towards the payment of the 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 1922.—The method provided for computing the tax for a fiscal year beginning in 1921 and ending in 1922 is as follows: The tax attributable to the calendar year 1921 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 1921, and determining the proportion of such tax which the number of months falling within the calendar year 1921 is of the number of months in the entire period. For credits for foreign taxes, see section 238 of the statute and article 611.

ART. 955. Illustrations of computation of tax for fiscal year.—(a) A corporation makes its return on the basis of a fiscal year ending March 31, 1921. Its invested capital and net income are \$100,000 and \$74,000, respectively, as computed under the Revenue Act of 1918, and \$100,000 and \$68,000, respectively, as computed under the present statute. Such a difference in amounts of net income may readily occur owing to differences in the provisions of the two statutes.

(1) The excess-profits tax, computed under the Revenue Act of 1918 upon the basis of an invested capital of \$100,000 and a net income of \$74,000, is \$23,400.

(2) The excess-profits tax computed under the Revenue Act of 1921, upon a basis of an invested capital of \$100,000 and a net income of \$68,000, is \$21,000.

(3) The total excess-profits tax for the fiscal year ending March 31, 1921, will be the sum of (a) the proportion of the tax computed under the Revenue Act of 1918 which the portion of the fiscal year falling within the calendar year 1920 is of the entire period (i. e., nine-twelfths of the excess-profits tax, \$23,400, computed under Revenue Act of 1918) or \$17,550, and (b) the proportion of the tax computed under the Revenue Act of 1921 which the portion of the fiscal year falling within the calendar year 1921 is of the entire period (i. e., three-twelfths of the excess-profits tax, \$21,000, computed under the Revenue Act of 1921) or \$5,250. The total excess-profits tax is \$17,550 plus \$5,250, or \$22,800.

(b) The excess profits tax for a fiscal year ending in 1922 will be an amount equivalent to the same proportion of a tax computed under this statute which the portion of such period falling within

the calendar year 1921 is of the entire period. In the case of a corporation making its return on the basis of a fiscal year ending March 31, 1922, having an invested capital and net income of \$100,000 and \$68,000, respectively, the excess-profits tax computed under the Revenue Act of 1921 will be \$21,000. The tax applicable to the fiscal year ending March 31, 1922, is \$15,750 (i. e., nine-twelfths of the excess-profits tax, \$21,000).

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, except life insurance companies, domestic or foreign, not exempt under section 304 of the statute and article 751, shall make a return for the purpose of 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 coming under the provisions of section 301(b) of the statute 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 such 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, or a corporation entitled to the benefits of section 262, 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 870. 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, or a corporation entitled to the benefits of section 262, 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 714, 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 219–221.

ART. 972. Illustration of computation of tax where sale of mineral deposits.—In the case of the corporation used as an illustration in article 715, let it be assumed that its gross income for 1921 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 714 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 \$9,240, or \$3,280.20. 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 \$5,959.80 (the portion of the tax not affected) plus \$3,000, or \$8,959.80 (instead of \$9,240).

EFFECTIVE DATE OF TITLE.

SEC. 338. That this title shall take effect as of January 1, 1921.

ART. 980. Effective dates.—This title takes effect as of January 1, 1921. It imposes no tax for any period prior to that date or subsequent to December 31, 1921.

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 a part of such installment interest thereon at the rate of one-half 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 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, to the extent not covered by any credits due to the taxpayer under section 252 (hereinafter called "deficiency"), together with interest thereon at the rate of one-half of 1 per centum per month from the time the tax was due (or, if paid on the installment basis, on the deficiency of each installment from the time the installment was due), shall be paid upon notice and demand by the collector. If any part of the deficiency is due to negligence or intentional disregard of authorized rules and regulations with knowledge

thereof, but without intent to defraud, there shall be added as part of the tax 5 per centum of the total amount of the deficiency in the tax, and interest in such a case shall be collected at the rate of 1 per centum per month on the amount of such deficiency in the tax from the time it was due (or, if paid on the installment basis, on the amount of the deficiency in each installment from the time the installment was due), which penalty and interest shall become due and payable upon notice and demand by the collector. If any part of the deficiency is due to fraud with intent to evade tax, then, in lieu of the penalty provided by section 3176 of the Revised Statutes, as amended, for false or fraudulent returns willfully 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 total amount of the deficiency in the tax. In such case the whole amount of the tax unpaid, including the penalty so added, shall become due and payable upon notice and demand by the collector.

(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) The amount of income, excess-profits, or war-profits taxes due under any return made under this Act for the taxable year 1921 or succeeding taxable years shall be determined and assessed by the Commissioner within four years after the return was filed, and the amount of any such taxes due under any return made under this Act for prior taxable years or under prior income, excess-profits, or war-profits tax Acts, or under 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, shall be determined and assessed within five years after the return was filed, unless both the Commissioner and the taxpayer consent in writing to a later determination, assessment, and collection of the tax; and no suit or proceeding for the collection of any such taxes due under this Act or under prior income, excess-profits, or war-profits tax Acts, or of any taxes due under section 38 of such Act of August 5, 1909, shall be begun, after the expiration of five years after the date when such return was filed, but this shall not affect suits or proceedings begun at the time of the passage of this Act: *Provided*, That in the case of income received during the lifetime of a decedent, all taxes due thereon shall be determined and assessed by the Commissioner within one year after written request therefor by the executor, administrator, or other fiduciary representing the estate of such decedent: *Provided further*, That in the case of a false or fraudulent return with intent to evade tax, or of a failure to file a required return, the amount of tax due may be determined, assessed, and collected, and a suit or proceeding for the collection of such amount may be begun, at any time after it becomes due: *Provided further*, That in cases coming within the scope of paragraph (9) of subdivision (a) of section 214, or of paragraph (8) of subdivision (a) of section 234, or in cases of final settlement of losses and other deductions tentatively allowed by the Commissioner pending a determination of the exact amount deductible, the amount of tax or deficiency in tax due may be determined, assessed, and collected at any time; but prior to the assessment thereof the taxpayer shall be notified

and given a period of not less than thirty days in which to file an appeal and be heard as hereinafter provided in this subdivision.

If upon examination of a return made under the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, or this Act, a tax or a deficiency in tax is discovered, the taxpayer shall be notified thereof and given a period of not less than thirty days after such notice is sent by registered mail in which to file an appeal and show cause or reason why the tax or deficiency should not be paid. Opportunity for hearing shall be granted and a final decision thereon shall be made as quickly as practicable. Any tax or deficiency in tax then determined to be due shall be assessed and paid, together with the penalty and interest, if any, applicable thereto, within ten days after notice and demand by the collector as hereinafter provided, and in such cases no claim in abatement of the amount so assessed shall be entertained: *Provided*, That in cases where the Commissioner believes that the collection of the amount due will be jeopardized by such delay he may make the assessment without giving such notice or awaiting the conclusion of such hearing.

(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 filed within ten days after notice and demand by the collector, where the taxpayer has not had the benefit of the provisions of subdivision (d), 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 one-half of 1 per centum per month on that part of the claim rejected.

In the case of the first installment provided for in subdivision (a) the instructions printed on the return shall be 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 sufficient notice of the amount due. In the case of each subsequent installment the collector may, within thirty days and not later than ten days before the installment becomes due, mail to the taxpayer notice of the amount of the installment and the date on which it is due for payment. Such notice of the collector shall be sufficient notice and sufficient demand under this section.

(f) In the case of any deficiency (except where the deficiency is due to negligence or to fraud with intent to evade tax) where it is shown to the satisfaction of the Commissioner that the payment of such deficiency would result in undue hardship to the taxpayer, the Commissioner may, with the approval of the Secretary, extend the time for the payment of such deficiency or any part thereof for such period not in excess of eighteen months from the passage of this Act as the Commissioner may determine. In such case the Commissioner may require the taxpayer to furnish a bond with sufficient sureties conditioned upon the payment of the deficiency in accordance with the terms of the extension granted. There shall be added in lieu of other interest provided by law, as a part of such deficiency, interest

thereon at the rate of two-thirds of 1 per centum per month from the time such extension is granted; except where such other interest provided by law is in excess of interest at the rate of two-thirds of 1 per centum per month. If the deficiency or any part thereof is not paid in accordance with the terms of the extension granted, there shall be added as part of the deficiency, in lieu of other interest and penalties provided by law, the sum of 5 per centum of the deficiency and interest on the deficiency at the rate of 1 per centum per month from the time it becomes payable in accordance with the terms of such extension.

(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 immediately terminated 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. In the case of a citizen of the United States about to depart from the United States the Commissioner may, at his discretion, waive any or all of the requirements placed on the taxpayer by this subdivision. No alien shall depart from the United States unless he first secures from the collector or agent in charge a certificate that he has complied with all the obligations imposed upon him by the income, war-profits, and excess-profits tax laws. If a taxpayer violates or attempts to violate this subdivision there shall, in addition to all other penalties, be added as part

of the tax 25 per centum of the total amount of the tax or deficiency in the tax, together with interest at the rate of 1 per centum per month from the time the tax became due.

(h) The provisions of subdivisions (e), (f) and (g) of this section shall apply to the assessment and collection of taxes which have accrued or may accrue under the Revenue Act of 1917, the Revenue Act of 1918 or this Act.

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 fixed by law for filing the return and the others at intervals of three months thereafter, or the whole tax may at the option of the taxpayer be paid in a single payment on or before the time fixed by law for filing the return, or such time as extended by the collector or the Commissioner. 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 until the expiration of the period of the extension, but will not postpone the date of the payment of the other installments unless the Commissioner so provides in granting the extension. Upon failure to pay an installment on time, all of the tax remaining unpaid becomes due and payable upon notice and demand by the collector. 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 tax or installment of tax, such excess 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 or deficiency, together with interest thereon at 6 per cent per annum from the time the tax was due, or if paid on the installment basis, on the deficiency of each installment from the time the installment was due, shall be paid upon notice and demand by the collector. See articles 1003, 1005, and 1006, and section 252 of the statute, and articles 1034–1036. The 6 per cent interest as above outlined does not attach to deficiencies discovered under Acts prior to the Revenue Act of 1921. The installment plan of payment has no application to a case where the return is fraudulent or was not filed on time. See article 1002.

ART. 1002. Payment of tax when no proper return.—Section 3176 of the Revised Statutes, as amended by the Revenue Act of 1918, re-enacted by section 1311 of the Revenue Act of 1921, 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 fraudulent the collector or his deputy is required to make the return from his own knowledge and from such information as he can obtain from testimony or otherwise. In such a case the Commissioner may from similar sources of information make the return or amend the return made by the collector or his deputy. The amount of tax determined to be due under the return as thus made for the taxpayer shall be paid in full upon notice and demand by the collector. The installment plan of payment has no application to such a case. See further articles 443-446, 1004, and 1005.

ART. 1003. Nonpayment of tax—Interest and penalty.—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 until paid. Except in the case of estates of insane, deceased, or insolvent persons, if any tax remains due and unpaid for 10 days after notice and demand by the collector (in the case of the first installment the instructions printed on the return and the taxpayer's computation of the tax on the return constitute notice and demand) there shall be added as part of the tax 5 per cent of the amount due but unpaid, plus interest at the rate of 12 per cent per annum from the due date, except that the interest on any amount which is the subject of a bona fide claim

in abatement filed within 10 days (where the taxpayer has not had the benefit of the notice and the 30-day period for filing an appeal as provided in sec. 250(d) and art. 1006) shall be at the rate of 6 per cent per annum and the 5 per cent penalty shall not be added. Upon receipt of notice of rejection of claim in abatement (or so much thereof as is not allowed) the collector will notify the claimant and demand 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 was not requested and the balance of the tax was not paid within the required 10 days, the 5 per cent penalty accrues immediately on such balance. 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 legal representative; but 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 the tax. See further articles 1004, 1005 and 1006. This article applies to the assessment and collection of taxes which have accrued or may accrue under the Revenue Act of 1918, and the Revenue Act of 1921, and except in so far as it relates to the installment plan of payment, under the Revenue Act of 1917.

Arr. 1004. Penalty for failure to file return.—In case of failure to file 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 failure to file it within the prescribed time is satisfactorily shown to the Commissioner to be due to a reasonable cause and not to willful neglect. This penalty is imposed by section 3176 of the Revised Statutes as amended. See section 1311 and article 1002. Two classes of delinquents are liable to 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. A taxpayer who files a tardy return and wishes to avoid the penalty must make an affirmative showing of all the facts alleged as a reasonable cause for failure to file the return on time in the form of an affidavit, which should be attached to the return. If such an affidavit 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 and not to willful neglect the 25 per cent penalty will not be assessed. If the taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the return in the prescribed time, then the delay is due to "rea-

sonable cause." See article 445. See also section 253 of the statute and article 1055.

ART. 1005. Deficiency in payment—Interest and penalty.—Section 250(b) provides that as soon as practicable after the return is filed the Commissioner shall examine it and if it is found that the amount already paid is less than that which should have been paid the deficiency, to the extent not covered by any credits under section 252, shall be paid upon notice and demand by the collector with interest and penalties, as follows: (1) If the deficiency arises under the Revenue Act of 1921 and is not due to negligence or intentional disregard of authorized rules and regulations or fraud with intent to evade the tax, interest shall be paid on the deficiency at the rate of 6 per cent per annum from the date the tax was due; or, if paid on the installment basis, on the deficiency of the installment from the time the installment was due. See article 1001. (2) If any part of the deficiency is due to negligence, but without intent to defraud, there shall be added as a penalty 5 per cent of the total amount of the deficiency together with interest on the amount of the deficiency at the rate of 12 per cent per annum from the time the tax was due, or, if paid on the installment basis, on the deficiency in each installment from the time the installment was due. Negligence is the absence of reasonable care under the circumstances. (3) If any part of the deficiency of the tax due under the Revenue Act of 1921 is the result of intentional disregard of rules and regulations prescribed by the Commissioner with the approval of the Secretary, with knowledge thereof, but without intent to defraud, there shall be added as a penalty 5 per cent of the total amount of the deficiency together with interest on the amount of the deficiency at the rate of 12 per cent per annum from the time the tax was due, or, if paid on the installment basis, on the amount of the deficiency in the installment from the time the installment was due. (4) If any part of the deficiency is due to fraud with intent to evade tax there shall be added as a penalty 50 per cent of the total amount of the deficiency, and the whole amount of the tax unpaid, including the penalty so added, shall become due and payable upon notice and demand. This penalty is in lieu of the 50 per cent penalty provided for in section 3176 of the Revised Statutes as amended (see section 1311 and article 1002), but is in addition to other penalties provided by law for false or fraudulent returns. See section 253 of the statute and article 1041.

ART. 1006. Appeals and hearings.—Section 250(d) of the Revenue Act of 1921 provides that if upon examination of a return made under the Revenue Act of 1916, 1917, 1918, or 1921, an income or excess profits tax or a deficiency therein (which deficiency is defined in section 250(b) as meaning the difference, to the extent not covered by

any credit due to the taxpayer under section 252, between the amount of the tax already paid and that which should have been paid) is discovered the taxpayer shall be notified thereof and shall have the right of an appeal and a hearing before an assessment is made. As soon as practicable, therefore, after a return is filed, whether by the taxpayer or as provided in section 3176 Revised Statutes, as amended, it is examined and if a tax or a deficiency in tax is discovered, the taxpayer shall be notified thereof by letter in which he shall be given a reasonable time in which to protest and file exceptions specifying the reasons why the tax or deficiency should not be assessed.

(a) If the taxpayer protests against the proposed assessment after the first notification by mail as above set forth, he will present his exceptions in writing to the income tax unit in Washington or to the division thereof where the said proposed assessment is being considered. Such exceptions must state fully the facts and grounds upon which the taxpayer relies. A reasonable additional time in which to file other data in support of the taxpayer's contentions may be allowed upon request showing cause for such extension. A hearing by the income tax unit shall be granted the taxpayer if requested by him; if no hearing is requested a decision will be made by the income tax unit upon the written data submitted. Whether a hearing is had or not a decision shall be made by the income tax unit at the earliest practicable date and the taxpayer notified thereof. The notification of the decision of the income tax unit shall be made by registered mail and a period of not less than thirty days given the taxpayer in which to file an appeal to the Commissioner and show cause or reason why such tax or deficiency should not be paid. Full thirty days from the mailing (not the receipt) of such notice to file an appeal shall be given the taxpayer. The appeal must be filed in the office of the Commissioner in Washington within thirty-one days from the mailing of the notice, but if it is mailed in time to be received by the Commissioner within such period in the ordinary course of the mails it will be considered as having been filed within such period. No particular form of appeal is required, but the appeal must set forth specifically the exceptions upon which it is taken. The appeal shall be under oath and must contain a statement that it is not taken for the purpose of delay. Opportunity for a hearing shall be granted if requested within a reasonable time. The taxpayer in his appeal may rely upon the data previously submitted, or he may obtain a reasonable extension of time if cause therefor is shown in which to file additional data, evidence or argument. Such request shall be under oath and must state specifically the reasons for additional time. When a decision has been made by the proper officer, employee or employees of the bureau and approved by the Commissioner, an

assessment, if any, shall be made forthwith in accordance with the terms of such decision.

(b) If the taxpayer does not protest within the time fixed by the first notification by mail, then and in that case the proposed assessment shall be the decision of the income tax unit and the taxpayer shall be notified thereof. This notification of the decision of the income tax unit shall be made by registered mail and a period of not less than thirty days given the taxpayer in which to file an appeal to the Commissioner and to show cause or reason why such tax or deficiency should not be paid. The procedure on said appeal shall be the same as in the case of an appeal to the Commissioner as provided in (a) above.

In the case of a return which is examined in the collector's office where a tax or deficiency of tax is discovered and notice of the proposed assessment is sent out by the collector, the procedure shall be the same in said collector's office as herein provided for in the income tax unit. The decision of the collector may be appealed from, which appeal shall be to the Commissioner at Washington, and shall follow the same procedure as provided for in (a) or (b) above.

No assessment under section 250(d) shall be made without notification to the taxpayer of his right to appeal and show cause, except that in any case where the Commissioner believes that the collection of the amount due will be jeopardized by delay, he may make the assessment without giving such notice or awaiting the conclusion of a hearing.

Where a taxpayer has been given an opportunity to appeal and has not done so, as above set forth, and an assessment has been made, or where a taxpayer has appealed and an assessment in accordance with the final decision on such appeal has been made, no claim in abatement of the assessment shall be entertained.

Where an assessment has been made without giving the taxpayer an opportunity to appeal or without awaiting a decision on an appeal that has been perfected, a bona fide claim in abatement of the assessment, filed within ten days after notice and demand by the collector, may be entertained.

ART. 1007. Notice and demand for payment.—In the case of the first installment provided for in subdivision (a) of section 250 the instructions printed on the return shall be sufficient notice of the date when the tax is due and sufficient demand: In the case of each subsequent installment the collector may within 30 days and not later than 10 days before the installment becomes due mail to the taxpayer notice (on Form 1123) of the amount of the installment and the date on which it is due for payment and such notice of the collector shall be sufficient notice and sufficient demand for the subsequent installment. In all other cases and in cases where the collector failed to

give advance notice on Form 1123, notice and demand will be given on Form 1-17a. The service of the notice and demand 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 from the date of its receipt by the taxpayer. But payment of 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 the absence from home or place of business in a foreign country 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 frequently impossible for a taxpayer to receive 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). 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 where it is established that a remittance for the tax was placed in the mails within the 10-day period after the due date specified in the notice, and tardiness was 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. A suit or proceeding for the collection of tax due under the Revenue Act of 1921, or prior income, excess profits, or war profits tax Acts, or under section 38 of the Act of August 5, 1909, may be brought at any time after the tax becomes due if the return filed by the taxpayer is false or fraudulent with intent to evade tax or if the taxpayer failed to file a required return; also in cases of amortization coming within the scope of paragraph (9) of subdivision (a) of section 214, or of paragraph (8) of subdivision (a) of section 234, of the Revenue Acts of 1918 and 1921 and in cases of final settlement of losses and other deductions tentatively allowed by the Commissioner pending a determination of the exact amount deductible, collection of the amount of tax or deficiency in tax due may be collected at any time. In other cases suits for the collection of taxes due under the Acts named may be brought at any time within five years after the return was

filed whether or not the taxes have been assessed or are assessable. Section 3164 of the Revised Statutes, as amended by the Revenue Act of 1918, reenacted by section 1311 of the Revenue Act of 1921, 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, or other property or rights of property, of the person delinquent. When goods, chattels, or effects sufficient to satisfy the taxes and penalties 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 Mar. 3, 1913), 3187-3196, 3197 (as amended by the Act of Mar. 1, 1879), 3198-3202, 3203 (as amended by the Act of Mar. 1, 1879), 3204-3207, 3208 (as amended by the Act of Mar. 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. **Liens and enforcement of tax liens by bill in equity.**—In the event of nonpayment of a tax and penalties after demand, the amount 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 bona fide mortgagee, purchaser, or judgment creditor until notice thereof is filed in the proper public office or offices on Form 668. The collector may file such notice of lien upon making demand for payment of the tax, unless payment is

made immediately upon demand. What is immediate payment will depend upon the nature of the demand. Where the collector contemplates filing such notice of lien on demand, whenever practicable, the demand should be made upon the taxpayer in person. 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 subject to the lien. This remedy does not supersede distraint but is cumulative.

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) civil and criminal cases; (b) cases whether before or after suit; and (c) 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 section 3229 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. As soon as practicable after the returns are received in the office of the Commissioner they are carefully audited in connection with any reports of examination that may have been made by agents of the Department. If error in the amount of tax as stated in the return is detected the tax is recomputed and if the amount is less than that shown in the return the excess will be credited or refunded. See section 252 of the statute and articles 1031-1038. If the amount is greater than that shown in the return the deficiency will be handled as provided in section 250(d) of the statute and article 1006. The amount of tax due under a return made under the Revenue Act of 1921 for the taxable year 1921 or succeeding taxable years must be determined and assessed within four years after the return was filed and the amount of tax due under a return made for prior years under this Act, or under prior income, excess profits or war profits tax Acts, or under section 38 of the Act of August 5, 1909, must be determined and assessed within five years after the return was filed, with the following exceptions: (1) Where the Commissioner and the taxpayer may consent in writing to a later determination, assessment and collection of the tax. (2) In the case of income received during the lifetime

of a decedent all taxes due thereon shall be determined and assessed within one year after written request therefor by the fiduciary or legal representative of the estate of such decedent. (3) In the case of a failure to file a required return the amount of tax due may be determined, assessed and collected at any time after it becomes due. (4) In the case of a false or fraudulent return with intent to evade tax the amount of tax due may be determined, assessed and collected at any time after it becomes due. (5) In cases of amortization coming within the scope of paragraph (9) of subdivision (a) of section 214, or of paragraph (8) of subdivision (a) of section 234 of the Revenue Acts of 1918 and 1921, or in cases of final settlement of losses and other deductions tentatively allowed by the Commissioner pending a determination of the exact amount deductible, the amount of tax due may be determined, assessed and collected at any time, but prior to the assessment the taxpayer shall be notified and given a period of not less than 30 days in which to file an appeal. See article 1006.

Where a taxpayer has had an opportunity to file an appeal and show cause or reason why an additional tax or deficiency in tax should not be paid no claim in abatement of the amount assessed shall be entertained, but in such a case if the taxpayer desires to contest the assessment he should pay the tax and file a claim for credit or refund. See section 252 of the statute and articles 1031 and 1034-1038.

Arr. 1013. Declaration of termination of taxable period.—Section 250 (g) provides that 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 upon evidence satisfactory to him declare the taxable period for such taxpayer immediately terminated and cause 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 301-306. Aliens departing from the United States will be required to obtain certificates of compliance with income tax obligations from the collector or revenue agent in charge. Aliens, whether resident or nonresident, who intend to depart from this country should appear before the collector or revenue agent in charge 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 revenue agent in charge will issue a certificate of compliance to the applicant. A certificate of compliance issued by a collector or reve-

nue agent in charge 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 which are or may 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 for the taxable year or by furnishing such other security as may be approved by the Commissioner. See section 1329. If a taxpayer violates or attempts to violate this subdivision of section 250, there shall, in addition to all other penalties, be added as part of the tax, 25 per cent of the amount of the tax, or deficiency therein, together with interest at the rate of 1 per cent per month from the time the tax became due.

ART. 1014. Extension of time for payment of deficiency.—Section 250 (f) of the Revenue Act of 1921 contains a special relief provision which will be in effect for only 18 months after November 23, 1921, the date of the passage of the Act. It provides that in the case of any deficiency in tax revealed on the examination of an income or profits tax return (except where the deficiency is due to negligence or to fraud with intent to evade tax) where it is shown to the satisfaction of the Commissioner that the payment of such deficiency would result in undue hardship to the taxpayer, the Commissioner may, with the approval of the Secretary, extend the time for the payment of such deficiency or any part thereof for a period not to extend beyond 18 months from November 23, 1921. Where such an extension is granted there is to be added as part of the deficiency in lieu of other interest provided by law, interest at the rate of two-thirds of 1 per cent per month from the time the extension is granted. Where such other interest provided by law, however, is in excess of two-thirds of 1 per cent per month the higher rate will be charged. If the deficiency or any part thereof is not paid in accordance with the terms of the extension agreement, there is to be added as part of the deficiency, in lieu of other interest and penalties provided by law, the sum of 5 per cent of the deficiency together with interest on the deficiency at the rate of 1 per cent per month from the time it became

payable under the terms of the extension agreement. The extension will be granted only in case the taxpayer establishes to the satisfaction of the Commissioner that without such extension undue hardship will result to the taxpayer. The term "undue hardship" means more than an inconvenience to the taxpayer. It is defined as meaning that substantial financial loss or sacrifice will result to the taxpayer from making payments of the deficiency at the due date. This provision of the statute is applicable only to deficiencies in taxes which have accrued or may accrue under the Revenue Act of 1917, the Revenue Act of 1918, or the Revenue Act of 1921, and the deficiency referred to is only such deficiency in tax as is revealed on the examination of an income or profits tax return. It has no application to deficiencies in taxes other than deficiencies in income and profits taxes under the three Acts named. No extension of time may be granted under subdivision (f) of section 250 for the payment of any regular installment of tax due as shown by the original return of the taxpayer.

Any application for the extension must be made under oath on Form 1127 in accordance with instructions printed thereon and must be accompanied by evidence showing that undue hardship to the taxpayer would result if the extension were refused. The extension will not be granted on a general statement of hardship, but in each case there must be furnished a statement of the specific facts showing what, if any, financial loss or sacrifice will result if the extension is not granted. The application should, wherever practicable, contain a certified statement of assets and liabilities of the taxpayer.

The application, with the evidence, must be filed with the collector, who will at once transmit it to the Commissioner with his recommendations as to the extension. When it is received by the Commissioner it will be examined and within 30 days either rejected or tentatively approved.

Where the application is tentatively approved and a bond is required it must be filed with the collector within 10 days after the notification by the Commissioner that a bond is required. It shall be conditioned for the payment of the deficiency and applicable penalties, if any, and interest in accordance with the terms of the extension to be granted and 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. In lieu of such a bond the taxpayer may file a bond secured by deposit of Liberty bonds or other bonds or notes of the United States equal in their total par value to the amount of the deficiency and applicable penalties, if any, and interest, as provided in section 1329 of the Revenue Act of 1921.

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 such 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 canceled 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, the Revenue Act of 1917, or the Revenue Act of 1918, 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: *Provided further*, That if upon examination of any return of income made pursuant to the Revenue Act of 1917, the Revenue Act of 1918, or this Act, the invested capital of a taxpayer is decreased by the Commissioner, and such decrease is due to the fact that the taxpayer failed to take adequate deductions in previous years, with the result that an amount of income tax in excess of that properly due was paid in any previous year or years, then, notwithstanding any other provision of law and regardless of the expiration of such five-year period, the amount of such excess shall,

without the filing of any claim therefor, be credited or refunded as provided in this section: *And provided further*, That nothing in this section shall be construed to bar from allowance claims for refund filed prior to the passage of the Revenue Act of 1918 under subdivision (a) of section 14 of the Revenue Act of 1916, or filed prior to the passage of this Act under section 252 of the Revenue Act of 1918.

ART. 1031. Authority for refund, credit, and abatement of tax.—Authority for the credit, refund and 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 the Revenue Act of 1918, and reenacted by section 1315 of this Act, which provides:

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, which was amended by the Revenue Act of 1918 and reenacted without change by section 1323 of the Revenue Act of 1921, provides:

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.

Section 3228 of the Revised Statutes, as amended by section 1316 of the Revenue Act of 1921, reads as follows:

All claims for the refunding or crediting of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty alleged to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, must be presented to the Commissioner of Internal Revenue within four years next after payment of such tax, penalty, or sum.

This section, except as modified by section 252, shall apply retroactively to claims for refund under the Revenue Act of 1916, the Revenue Act of 1917, and the Revenue Act of 1918.

Claims in abatement of income and excess profits taxes will not be entertained where the taxpayer has had the benefits of section 250(d). See article 1006. Authority for the abatement of uncollectible taxes due from persons absconded or insolvent is contained in section 3218 of the Revised Statutes. The provisions of section 252 apply to the income and war profits and excess profits taxes imposed by the present statute and also to the excise taxes under the Act of 1909, the income tax under the Acts of 1913 and 1916 and the income and excess profits taxes under the Acts of 1917 and 1918.

ART. 1031 (a). Refund, credit, and abatement adjustments.—Reduction of internal revenue assessments and adjustments of overpayments of revenues will be accomplished in one of three ways:

(a) On the basis of an application submitted by a taxpayer on Form 843, 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, a schedule of taxes found to be uncollectible, or a schedule of duplicate payments and overpayments due to obvious error on all forms of taxable returns submitted by a collector of internal revenue.

In cases covered by (b) the taxpayer need not file a claim. Proper adjustment will be made in the bureau and notice thereof forwarded to the taxpayer.

ART. 1032. Claims for abatement of taxes erroneously assessed.—Claims for abatement of taxes illegally or erroneously assessed shall be made on Form 843. 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 to him. 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. Claims for abatement may not be filed where the taxpayer has had the benefit of the provisions of section 250(d). See article 1006. A collector may himself present once a month a blanket claim on Form 843 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. 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 843, which shall be sworn to and shall contain the following statements: (a) Business engaged in by the claimant; (b) character of assessment or tax; (c) amount of tax claimed as a credit; (d) unpaid assessment against which credit is asked and for what taxable year; and (e) 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 Form 843, stating thereon the respective amounts claimed as a credit or as a refund. See article 1036. All the facts regarding the total overpayment should be stated in the claim.

ART. 1035. Action on claims for credit.—Upon receipt by the collector of a claim for credit on Form 843, he will make proper record thereof in his office and, except in the case of claims covering tax assessed on the basis of returns on Form 1040A, forward the claim immediately to the Commissioner irrespective of whether or not a claim for refund of the tax now claimed as a credit has previously

been filed. Due notice will be given the collector and the taxpayer of the action taken on the claim.

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 entitled to credit for an alleged overpayment of tax prior to the allowance of such credit by the Commissioner. An attempt to take a credit prior to such allowance shall not be held to be the filing of a claim under section 252 of the Revenue Act of 1921.

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 843. In this case 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. In the case of the taxpayer's death, certified copies of the letters of administration or letters testamentary, or other similar evidence, must 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. Checks 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 directly to the proper persons. The Commissioner has no authority to refund on equitable grounds penalties legally collected. As to claims for refund of sums recovered by suit see article 1051.

ART. 1037. Special relief where invested capital reduced by Commissioner.—Section 252 of the statute provides that where an amount of income tax in excess of that properly due was paid in prior years (such excess payment being disclosed by subsequent action of the Commissioner requiring decrease of invested capital due to the fact that the taxpayer failed to take adequate depreciation or other deductions in previous years), such excess amount of income tax shall be credited or refunded to the taxpayer regardless of the possible expiration of the five-year period of limitation. This applies to returns filed under the Revenue Acts of 1917, 1918, and 1921. The

Commissioner is directed to grant this relief without requiring the filing of a claim therefor.

ART. 1038. Refunds under prior Acts.—Under section 252 of the Revenue Act of 1921 any claim for refund filed prior to the passage of the Revenue Act of 1918 under section 14(a) of the Revenue Act of 1916 or filed prior to passage of the Revenue Act of 1921 under section 252 of the Revenue Act of 1918 may be allowed if at the time it was filed it was properly allowable under the refunding provision of the Act in effect at the time.

INTEREST ON REFUNDS AND JUDGMENTS.

SEC. 1324. (a) That upon the allowance of a claim for the refund of or credit for internal revenue taxes paid, interest shall be allowed and paid upon the total amount of such refund or credit at the rate of one-half of 1 per centum per month to the date of such allowance, as follows: (1) if such amount was paid under a specific protest setting forth in detail the basis of and reasons for such protest, from the time when such tax was paid, or (2) if such amount was not paid under protest but pursuant to an additional assessment, from the time such additional assessment was paid, or (3) if no protest was made and the tax was not paid pursuant to an additional assessment, from six months after the date of filing of such claim for refund or credit. The term "additional assessment" as used in this section means a further assessment for a tax of the same character previously paid in part.

(b) Section 177 of the Judicial Code is amended to read as follows:

"SEC. 177. No interest shall be allowed on any claim up to the time of the rendition of judgment by the Court of Claims, unless upon a contract expressly stipulating for the payment of interest, except that interest may be allowed in any judgment of any court rendered after the passage of the Revenue Act of 1921 against the United States for any internal-revenue tax erroneously or illegally assessed or collected, or for any penalty collected without authority or any sum which was excessive or in any manner wrongfully collected, under the internal-revenue laws."

ART. 1040. Interest on refunds and judgments.—Section 1324 of the Act provides that after the passage of the Act interest in certain cases shall be paid on refunds or credits of internal revenue taxes paid under this or prior internal revenue acts to the date of the allowance of such refunds or credits at the rate of one-half of 1 per cent per month. A claim for refund or credit is allowed within the meaning of the statute when the Commissioner approves the schedule in whole or in part, for transmission to the proper accounting officer, for credit or refund. The date at which interest begins is as follows: (1) If the amount of tax was paid under specific protest, setting forth in detail the basis of and reasons for such protest, from the time the tax was paid; or (2) if such amount was not paid

under protest but pursuant to an additional assessment, from the time the additional assessment was paid; or (3) if no protest was made and the tax was not paid pursuant to an additional assessment, from six months after the date of filing such claim for refund or credit. In other words, under (3) if a taxpayer voluntarily pays a tax and later discovers that he has overpaid the tax, he may get interest only from six months subsequent to the filing of such claim. The statute further provides that the term "additional assessment," as used in section 1324 of the statute, means a further assessment for a tax of the same character previously paid in part. Thus an income tax is not of the "same character" as a capital stock tax.

Section 177 of the Judicial Code, amended by section 1324 of this Act, provides that interest may be allowed in any judgment of any court rendered after the passage of the Revenue Act of 1921 against the United States for any internal revenue tax erroneously or illegally assessed or collected or for any penalty collected without authority or any sum which was excessive or in any manner wrongfully collected under the internal revenue laws.

LIMITATIONS UPON SUITS AND PROSECUTIONS.

SEC. 1318. That section 3226 of the Revised Statutes is amended to read as follows:

"Sec. 3226. No suit or proceeding shall be maintained in any court for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Commissioner of Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof. No such suit or proceeding shall be begun before the expiration of six months from the date of filing such claim unless the Commissioner renders a decision thereon within that time, nor after the expiration of five years from the date of the payment of such tax, penalty, or sum."

This section shall not affect any suit or proceeding instituted prior to the passage of this Act, but shall apply to all suits and proceedings instituted after the passage of this Act, whether or not barred by prior Acts of Congress.

SEC. 1319. That section 3227 of the Revised Statutes is hereby repealed but such repeal shall not affect any suit or proceeding instituted prior to the passage of this Act.

SEC. 1320. That no suit or proceeding for the collection of any internal revenue tax shall be begun after the expiration of five years from the time such tax was due, except in the case of fraud with intent to evade tax, or willful attempt in any manner to defeat or evade tax. This section shall not apply to suits or proceedings for the collection of taxes under section 250 of this Act, nor to suits or proceedings begun at the time of the passage of this Act.

ART. 1050. Suits for recovery of taxes erroneously collected.—Under the provisions of section 1318 of the Revenue Act of 1921, suit for the recovery of taxes or penalties can not be maintained until a claim for refund or credit has been duly filed with the Commissioner, and six months have elapsed from the date of filing such claim, unless the Commissioner renders a decision within six months, in which case suit may be brought upon the rendition of the decision. Suit can not be brought after the expiration of five years from the date of the payment of a tax, penalty, or other sum. This section does not affect any suit or proceeding instituted prior to the passage of the Revenue Act of 1921. Section 1319 repeals section 3227 of the Revised Statutes, which limited the bringing of suit to two years next after the cause of action accrued. Under section 3227, which applies to suits instituted prior to the passage of the Revenue Act of 1921, the cause of action accrued upon an unfavorable decision by the Commissioner, or at the expiration of six months after an appeal without action thereon by the Commissioner. No suit for the purpose of restraining the assessment or collection of any taxes 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 can not be waived by any officer of the Government. See sections 3224, 3225 (as amended by the Revenue Act of 1918) and 3226 (as amended by the Revenue Act of 1921) of the Revised Statutes. Under section 1320 no suit or proceeding for the collection of any internal revenue tax shall be begun after the expiration of five years from the time such tax was due, except in case of fraud with intent to evade tax, or willful attempt in any manner to defeat or evade tax. This section does not apply to suits or proceedings begun at the time of the passage of the Revenue Act of 1921, or to suits or proceedings for the collection of taxes under section 250 of that Act. See section 250 (d) and articles 1008 and 1012.

ART. 1051. 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 843. 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 internal revenue officer 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 articles 1031 and 1040

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. 1055. 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 enforceable 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. 1060. **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. 1065. **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 1921 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, accompanied by a letter of transmittal on Form 1096 showing the number of returns filed. 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 of \$1,000 or over 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 case an employer has a large number of employees and the computation of exact amounts paid during the calendar year will result in an undue hardship, careful estimates may be made on the basis of any representative month, and unless the yearly payment based on this

estimate in the case of any employee amounts to \$1,000 or more, no return of payments to such employee is required.

ART. 1073. 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: (*a*) Payments of interest on obligations of the United States; (*b*) dividends paid by domestic or resident foreign corporations; (*c*) payments by a broker to his customers; (*d*) payments of any type made to corporations; (*e*) bills paid for merchandise, telegrams, telephone, freight, storage, professional services, and similar charges; (*f*) annuities representing the return of capital; (*g*) 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); (*h*) payments made by branches of business houses located in foreign countries to alien employees serving in foreign countries; and (*i*) payments made by the United States Government to sailors and soldiers and to its civilian employees.

ART. 1074. 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. No ownership certificate is required to be filed in case bonds or other obligations are owned by domestic or resident corporations. See sections 221 and 237 of the statute and articles 361–375 and 601.

ART. 1075. Return of information as to payments to nonresident aliens.—In the case of payments of annual or periodical income to nonresident alien individuals, partnerships composed in whole or in part of nonresident aliens and not having an office or place of business within the United States, 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 filed by withholding agents on Form 1042 shall constitute and be treated as returns of information. See sections 221 and 237 of the statute and articles 361–375 and 601.

ART. 1076. 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 ap-

pointed 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. No return of information is required with respect to foreign items owned by a nonresident alien individual, a foreign partnership, or a foreign corporation, provided the first bank or collecting agent is satisfied as to such ownership. In such case the foreign item may be stamped "foreign owner."

ART. 1077. Ownership certificates for foreign items.—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 resident partnerships, ownership certificate Form 1001 A 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, 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 should be filed. See article 361.

ART. 1078. 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, a statement and ownership certificate, Form 1000, shall be furnished as provided in article 369.

In the case of other foreign items which are received unaccompanied by an ownership certificate and the owner is unknown, a statement 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, crossing out the word "owner" and substituting therefor the word "payee." The first bank shall stamp or write across the face of the certificate "statement furnished," adding the name of the bank.

Thereupon the statement 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. 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 is used, a monthly return shall be made on Form 1012 and an annual return on Form 1013, as provided in articles 361-375. Forms 1012 and 1013, 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 1055.

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 stock-

holders 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. 1090. 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 24, 1922, 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 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 sec. 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, District of Columbia.

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.

ART. 1091. 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.

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 1921 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, except the Revenue Act of 1918.

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 Acts of 1918 or 1921, and all returns of corporations filed for purposes of the tax imposed by section 1000, Title X, of said Acts. 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 1076, 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. Appli-

cation Form 1017 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 1076-1079.

CITIZENS OF POSSESSIONS OF THE UNITED STATES.

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.

Nothing in this section shall be construed to alter or amend the provisions of the Act entitled "An Act making appropriations for the naval service for the fiscal year ending June 30, 1922, and for other purposes," approved July 12, 1921, relating to the imposition of income taxes in the Virgin Islands of the United States.

ART. 1121. **Status of citizen of United States possession.**—A citizen of a possession of the United States (except the Virgin Islands), 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 92-94, 271, 306, 311, 316, and 404. His income from sources within the United States is subject to withholding. See section 221 and articles 361-375. The Act referred to in section 260 of the statute provided that income tax laws then or thereafter in force in the United States should apply to the Virgin Islands, but that the taxes should be paid into the treasury of the Virgin Islands. Accordingly, a citizen or resident of the Virgin Islands is taxed there under the provisions of the Revenue Act of 1921.

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 as provided by law prior to the passage of this Act.

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 1921 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 381–386. (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. See further section 238. 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.

INCOME FROM SOURCES WITHIN THE POSSESSIONS OF THE UNITED STATES.

SEC. 262. (a) That in the case of citizens of the United States or domestic corporations, satisfying the following conditions, gross income means only gross income from sources within the United States—

(1) If 80 per centum or more of the gross income of such citizen or domestic corporation (computed without the benefit of this section) for the three-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession of the United States; and

(2) If, in the case of such corporation, 50 per centum or more of its gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States; or

(3) If, in the case of such citizen, 50 per centum or more of his gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States either on his own account or as an employee or agent of another.

(b) Notwithstanding the provisions of subdivision (a) there shall be included in gross income all amounts received by such citizens or corporations within the United States, whether derived from sources within or without the United States.

(c) As used in this section the term "possession of the United States" does not include the Virgin Islands of the United States.

ART. 1135. Citizens of the United States deriving income from sources within a possession of the United States.—The gross income of a citizen of the United States (1) 80 per cent or more of whose gross income (computed without the benefit of this article) for the three-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession of the United States, and (2) 50 per cent or more of whose gross income (computed without the benefit of this article) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States, either on his own account or as an employee or agent of another, means only gross income from sources within the United States. For a determination of the income from sources within the United States, see section 217 and articles 311–329.

ART. 1136. Domestic corporation deriving income from sources within a possession of the United States.—The gross income of a domestic corporation (1) 80 per cent or more of the gross income of which (computed without the benefit of this article) for the three-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable

year as may be applicable) was derived from sources within a possession of the United States, and (2) 50 per cent or more of the gross income of which (computed without the benefit of this article) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States, means only gross income from sources within the United States. See section 217 and articles 316-329.

ART. 1137. Income received within the United States.—Notwithstanding the provisions of articles 1135 and 1136, there shall be included in gross income of citizens and domestic corporations therein specified all amounts, whether derived from sources within or without the United States, which are received by such citizens or corporations within the United States. From the amounts so included in gross income there shall be deducted only the expenses properly apportioned or allocated thereto. The term "United States" as used herein includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia. The term "possession of the United States" as used in articles 1135, 1136, and this article includes Porto Rico, the Philippine Islands, the Panama Canal Zone, Guam, Tutuila, Wake, and Palmyra; it does not include the Virgin Islands.

FINAL DETERMINATIONS AND ASSESSMENTS.

SEC. 1312. That if after a determination and assessment in any case the taxpayer has without protest paid in whole any tax or penalty, or accepted any abatement, credit, or refund based on such determination and assessment, and an agreement is made in writing between the taxpayer and the Commissioner, with the approval of the Secretary, that such determination and assessment shall be final and conclusive, then (except upon a showing of fraud or malfeasance or misrepresentation of fact materially affecting the determination or assessment thus made) (1) the case shall not be reopened or the determination and assessment modified by any officer, employee, or agent of the United States, and (2) no suit, action, or proceeding to annul, modify, or set aside such determination or assessment shall be entertained by any court of the United States.

ART. 1141. Final determination of tax or penalty.—Section 1312 of the Revenue Act of 1921 provides a method whereby a determination by the Commissioner of the amount of tax or penalty due may become finally conclusive upon the making of an agreement to that effect between the taxpayer and the Commissioner with the approval of the Secretary. Such agreement may be made where the taxpayer has (1) without protest paid in whole any tax or penalty, (2) accepted any abatement, (3) accepted any credit, or (4) accepted any refund, based upon a determination and assessment by the Commissioner. When such agreement is entered into, the case shall not be

reopened or the determination and assessment modified by any officer, employee, or agent of the United States, and no suit, action, or proceeding to annul, modify, or set aside such determination or assessment shall be entertained by any court of the United States except upon a showing of fraud or malfeasance or misrepresentation of fact materially affecting the determination or assessment thus made. In case the taxpayer is a corporation a certified copy of the minutes of the board of directors authorizing an officer or officers of such corporation to enter into such agreement shall be filed with such agreement at the time of the execution thereof. Such agreements shall be executed in duplicate, one to be placed in the files of the case in the bureau and one to be given to the taxpayer.

PART IV.

DEFINITIONS AND GENERAL PROVISIONS.

GENERAL DEFINITIONS.

SECTION 1. That this Act may be cited as the "Revenue Act of 1921."

SEC. 2. That when used in this Act—

(1) The term "person" includes partnerships and corporations, as well as individuals;

(2) The term "corporation" includes associations, joint-stock companies, and insurance companies;

(3) The term "domestic" when applied to a corporation or partnership means created or organized in the United States;

(4) The term "foreign" when applied to a corporation or partnership means created or organized outside the United States;

(5) 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;

(6) The term "Secretary" means the Secretary of the Treasury;

(7) The term "Commissioner" means the Commissioner of Internal Revenue;

(8) The term "collector" means collector of internal revenue;

(9) The term "taxpayer" includes any person, trust or estate subject to a tax imposed by this Act;

(10) 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 terms; and

(11) 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 subdivision, 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.

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. A corporation which has ceased to exist in contemplation of law but continues its business in corporate form is an association or corporation within the meaning of section 2, but if it continues its business in the form of a trust, it becomes subject to the provisions of section 219.

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 341–348. 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.

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 311–315.

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. The term "Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive," includes 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 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 Revenue Act of 1918 and article 1510 of Regulations 45. 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 (e), 301 (b), and 327 (d).

DEFINITIONS.

SEC. 200. That when used in this title—

(1) 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 1921, shall be the calendar year 1921 or any fiscal year ending during the calendar year 1921 ;

(2) 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 ;

(3) The term "withholding agent" means any person required to deduct and withhold any tax under the provisions of section 221 or section 237 ;

(4) 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 ; and

(5) 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.

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 or guardian 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 commission 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," "withholding 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 361–375. "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 receipts 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 and paragraph (4) of subdivision (a) of section 245) means any distribution made by a corporation to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 28, 1913, except a distribution made by a personal service corporation out of earnings or profits accumulated since December 31, 1917, and prior to January 1, 1922.

(b) For the purposes of this Act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed. If any such tax-free distribution has been made the distributee shall not be allowed as a deduction from gross income any loss sustained from the sale or other disposition of his stock or shares unless, and then only to the extent that, the basis provided in section 202 exceeds the sum of (1) the amount realized from the sale or other disposition of such stock or shares, and (2) the aggregate amount of such distributions received by him thereon.

(c) Any distribution (whether in cash or other property) made by a corporation to its shareholders or members otherwise than out of

(1) earnings or profits accumulated since February 28, 1913, or (2) earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, shall be applied against and reduce the basis provided in section 202 for the purpose of ascertaining the gain derived or the loss sustained from the sale or other disposition of the stock or shares by the distributee.

(d) A stock dividend shall not be subject to tax but if after the distribution of any such dividend the corporation proceeds to cancel or redeem its stock at such time and in such manner as to make the distribution and cancellation or redemption essentially equivalent to the distribution of a taxable dividend, the amount received in redemption or cancellation of the stock shall be treated as a taxable dividend to the extent of the earnings or profits accumulated by such corporation after February 28, 1913.

(e) For the purposes of this Act, a taxable distribution made by a corporation to its shareholders or members shall be included in the gross income of the distributees as of the date when the cash or other property is unqualifiedly made subject to their demands.

(f) 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. This subdivision shall not be in effect after December 31, 1921.

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. 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 53 and 858. The term "dividends" does not, however, include a distribution made by a personal service corporation out of earnings or profits accumulated since December 31, 1917, and prior to January 1, 1922.

A taxable distribution made by a corporation to its stockholders or members shall be included in the gross income of the distributees when the cash or other property is unqualifiedly made subject to their demands. See article 53.

ART. 1542. Source of distribution.—(a) For the purpose of income taxation every distribution made by a corporation is made out of earnings or profits and from the most recently accumulated earn-

ings or profits, to the extent of such earnings or profits accumulated since February 28, 1913;

(b) Every distribution made by a corporation during the first 60 days of a taxable year shall be deemed to have been made from earnings or profits accumulated during preceding taxable years. Every distribution made during the remainder of the taxable year after the first 60 days shall be deemed to have been made from earnings or profits accumulated during the taxable year up to the date of the distribution to the extent of such earnings or profits. The presumptions contained in this paragraph affect the determination of invested capital for the purpose of the excess profits tax, and are not in effect after December 31, 1921. They have no effect upon the rates at which dividends paid in 1921 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 excess profits taxes. See article 857.

In the case of a personal service corporation every distribution is made out of earnings or profits and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913. Such a distribution, if made during the first 60 days of a taxable year, shall be deemed to have been made from the most recently accumulated earnings or profits of preceding taxable years, and if made during the remainder of the taxable year after the first 60 days, from earnings or profits accumulated during the taxable year up to the date of distribution to the extent of such earnings or profits. The presumption contained in the preceding sentence is not in effect after December 31, 1921. As stated in article 1541 the term "dividend" does not include a distribution made by a personal service corporation out of earnings or profits accumulated since December 31, 1917, and prior to January 1, 1922.

ART. 1543. Distribution out of earnings or profits accumulated prior to March 1, 1913.—Any distribution by a corporation out of earnings or profits accumulated prior to March 1, 1913, or out of increase of value of property accrued prior to March 1, 1913 (whether or not realized by sale or other disposition), is not a dividend within the meaning of the Act. The provisions of the preceding sentence shall be applied uniformly to cases arising under the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, as well as the Revenue Act of 1921. A corporation can not distribute earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, unless and until all earnings or profits accumulated since February 28, 1913, have been distributed. In determining whether a dividend is out of earnings or profits accumulated prior or

subsequent to March 1, 1913, due consideration must be given to the facts, and mere bookkeeping entries increasing or decreasing surplus will not be conclusive.

A distribution made by a corporation out of earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, is exempt from tax, even if in excess of the cost or other basis provided in articles 1561-1563 and 1568, of the stock on which declared. However, where any tax-free distribution out of earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, has been made, the distributee can not deduct any loss from the sale or other disposition of the stock unless and then only to the extent that the cost, or other basis, exceeds the sum of (1) the amount realized from the sale or other disposition of the stock, and (2) the aggregate amount of such distributions received by him thereon.

Example.—A purchased certain stock subsequent to March 1, 1913, for \$10,000 and received in 1921 a distribution thereon of \$2,000, paid out of the earnings or profits of the corporation accumulated prior to March 1, 1913. This distribution does not constitute taxable income to A. If A subsequently sells the stock for \$6,000 a deductible loss of \$2,000 is sustained. If he sells the stock for \$12,000, a taxable gain of \$2,000 is realized. No gain or loss is recognized if he sells the stock for an amount ranging between \$8,000 and \$10,000.

ART. 1544. Distributions other than those out of earnings or profits.—Any distribution made by a corporation to its stockholders otherwise than out of (1) earnings or profits accumulated since February 28, 1913, or (2) earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, is not a dividend and is not taxable to the recipient. Any such distribution, however, shall be applied against and reduce the cost, or other basis, of the stock upon which declared, for the purpose of determining the gain or loss from the subsequent sale of the stock.

Example.—A purchased certain stock in 1915 for \$10,000 and received in 1921 a distribution thereon of \$2,000 paid by the corporation otherwise than out of its earnings or profits or the increase in value of property accrued prior to March 1, 1913. This distribution does not constitute taxable income to A. If A subsequently sells the stock the difference between the amount realized therefor and \$8,000 is taxable gain or deductible loss, as the case may be.

ART. 1545. Distributions in liquidation.—Where a corporation distributes all of its property in complete liquidation or dissolution, the gain realized by the stockholder from the transaction, computed under section 202, is taxable as a dividend to the extent that it is paid out of earnings or profits of the corporation accumulated since February 28, 1913. If the amount received by the stockholder in liquida-

tion is less than the cost or other basis of the stock, a deductible loss is sustained.

ART. 1546. Distribution from depletion or depreciation reserves.—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 surplus out of which ordinary dividends may be paid. A distribution made from a depletion or depreciation reserve based upon the cost of the property will not be considered as having been paid out of earnings or profits, but the amount thereof shall be applied against and reduce the cost, or other basis, of the stock upon which declared for the purpose of determining the gain or loss from the subsequent sale of the stock. A distribution made from that portion of a depletion reserve based upon a valuation as of March 1, 1913, which is in excess of the depletion reserve based upon cost, will not be considered as having been paid out of earnings or profits, but the distributee shall not be allowed as a deduction from gross income any loss sustained from the sale or other disposition of his stock or shares unless, and then only to the extent that, the basis provided in section 202 exceeds the sum of (1) the amount realized from the sale or other disposition of such stock or shares, and (2) the aggregate amount of such distributions received by him thereon. No distribution, however, can be made from such a reserve until all the earnings or profits of the corporation have first been distributed.

ART. 1547. 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 market value of such property when receivable by the stockholders. A dividend paid in stock of another corporation is not a stock dividend, even though the stock distributed was acquired through the transfer by the corporation declaring the dividend, of property to the corporation the stock of which is distributed as a 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 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. 1548. Sale of stock received as dividend.—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, 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 (or 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 (or 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 art. 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.

(4) Where the stock with respect to which a stock dividend is declared was purchased at different times and at different prices, and the dividend stock issued 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, to the amount of the stock dividend chargeable to such stock.

ART. 1549. Declaration and subsequent redemption of a stock dividend.—A true stock dividend is not subject to tax on its receipt in the hands of the recipient. See article 1548. Nevertheless, if a corporation, after the distribution of a stock dividend, proceeds to cancel or redeem its stock at such time and in such manner as to make the distribution and cancellation or redemption essentially equivalent to the distribution of a taxable dividend, the amount received in re-

demption or cancellation of the stock shall be treated as a taxable dividend to the extent of the earnings or profits accumulated by such corporation after February 28, 1913.

BASIS FOR DETERMINING GAIN OR LOSS.

SEC. 202. (a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that—

(1) In the case of such property, which should be included in the inventory, the basis shall be the last inventory value thereof;

(2) In the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner. In the case of such property acquired by gift on or before December 31, 1920, the basis for ascertaining gain or loss from a sale or other disposition thereof shall be the fair market price or value of such property at the time of such acquisition;

(3) In the case of such property, acquired by bequest, devise, or inheritance, the basis shall be the fair market price or value of such property at the time of such acquisition. The provisions of this paragraph shall apply to the acquisition of such property interests as are specified in subdivision (c) or (e) of section 402.

(b) The basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, shall be the same as that provided by subdivision (a); but—

(1) If its fair market price or value as of March 1, 1913, is in excess of such basis, the gain to be included in the gross income shall be the excess of the amount realized therefor over such fair market price or value;

(2) If its fair market price or value as of March 1, 1913, is lower than such basis, the deductible loss is the excess of the fair market price or value as of March 1, 1913, over the amount realized therefor; and

(3) If the amount realized therefor is more than such basis but not more than its fair market price or value as of March 1, 1913, or less than such basis but not less than such fair market price or value, no gain shall be included in and no loss deducted from the gross income.

(c) For the purposes of this title, on an exchange of property, real, personal or mixed, for any other such property, no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value; but even if the property received in exchange

has a readily realizable market value, no gain or loss shall be recognized—

(1) When any such property held for investment, or for productive use in trade or business (not including stock-in-trade or other property held primarily for sale), is exchanged for property of a like kind or use;

(2) When in the reorganization of one or more corporations a person receives in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization. The word "reorganization," as used in this paragraph, includes a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or of substantially all the properties of another corporation), recapitalization, or mere change in identity, form, or place of organization of a corporation, (however effected); or

(3) When (A) a person transfers any property, real, personal or mixed, to a corporation, and immediately after the transfer is in control of such corporation, or (B) two or more persons transfer any such property to a corporation, and immediately after the transfer are in control of such corporation, and the amounts of stock, securities, or both, received by such persons are in substantially the same proportion as their interests in the property before such transfer. For the purposes of this paragraph, a person is, or two or more persons are, "in control" of a corporation when owning at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

(d) (1) Where property is exchanged for other property and no gain or loss is recognized under the provisions of subdivision (c), the property received shall, for the purposes of this section, be treated as taking the place of the property exchanged therefor, except as provided in subdivision (e);

(2) Where property is compulsorily or involuntarily converted into cash or its equivalent in the manner described in paragraph (12) of subdivision (a) of section 214 and paragraph (14) of subdivision (a) of section 234, and the taxpayer proceeds in good faith to expend or set aside the proceeds of such conversion in the form and in the manner therein provided, the property acquired shall, for the purpose of this section, be treated as taking the place of a like proportion of the property converted.

(3) Where no deduction is allowed for a loss or a part thereof under the provisions of paragraph (5) of subdivision (a) of section 214 and paragraph (4) of subdivision (a) of section 234, that part of the property acquired with relation to which such loss is disallowed shall for the purposes of this section be treated as taking the place of the property sold or disposed of.

(e) Where property is exchanged for other property which has no readily realizable market value, together with money or other property which has a readily realizable market value, then the money or the fair market value of the property having such readily realizable market value received in exchange shall be applied against and reduce the basis, provided in this section, of the property exchanged, and if in excess of such basis, shall be taxable to the extent of the excess; but when property is exchanged for property specified in paragraphs

(1), (2), and (3) of subdivision (c) as received in exchange, together with money or other property of a readily realizable market value other than that specified in such paragraphs, the money or the fair market value of such other property received in exchange shall be applied against and reduce the basis, provided in this section, of the property exchanged, and if in excess of such basis, shall be taxable to the extent of the excess.

(f) Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received.

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 in the case of property which should be included in the inventory, its latest 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 to be included in gross income 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 in computing gain or loss from the exchange or sale of property for any depreciation or depletion sustained and allowable as a deduction in computing net income; the amount of depreciation previously charged off by the taxpayer shall be deemed to be the true depreciation sustained unless shown by clear and convincing evidence to be incorrect. 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. In the case of property traded in on public exchanges, evidence of actual sales at or about March 1, 1913, or other basic date, affords evidence of value, but it must not be regarded as conclusive. The nature and extent of the sales and the circumstances under which they were made should be considered. Prices received at forced sales or for small lots of property may be and often are no real indication of the value of the amount of property in question. For instance, sales from time to time of a small number of shares of stock is little indication of the value of a large or controlling interest in the corporation. As to inventories, see section 203 of the statute and articles 1581-1588. As to sale of stock upon which dividends have been declared, see articles 1543, 1544, and 1546. 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. As to exchanges, see further, articles 1564-1568. If the taxpayer can not determine the cost of securities purchased prior to March 1, 1913, because of the loss, destruction or failure to keep records, the value of the securities at the date or approximate date of acquisition may be used in determining the cost basis for purposes of computing the gain or loss from the sale of the securities. When the date or approximate date of acquisition is unknown, no general rule can be stated for determining the cost value of such securities. Each case must be considered separately upon its own facts.

Illustrations of the computation of gain or loss from the sale or exchange of property acquired prior to March 1, 1913.—To avoid complexity no adjustment has been made in these examples for depreciation or depletion.

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 taxable gain is the excess of the amount realized therefor over such fair market value.

Cost.	Fair market value March 1, 1913.	Sale price.	Taxable gain.
\$10,000	\$15,000	\$20,000	\$5,000. Excess of amount realized over fair market value as at March 1, 1913. Gain attributable to the period prior to March 1, 1913, not taxable.

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.

Cost.	Fair market value March 1, 1913.	Sale price.	Deductible loss.
\$10,000	\$5,000	\$3,000	\$2,000. Excess of fair market value over amount realized. Loss attributable to the period prior to March 1, 1913, not deductible.

No gain or loss is recognized in the case of property acquired before March 1, 1913, and sold or disposed of at more than cost but at less than its fair market value as of that date.

Cost.	Fair market value March 1, 1913.	Sale price.	
\$10,000	\$30,000	\$20,000	No taxable gain or deductible loss. Reason: A gain on whole transaction, which gain is attributable to period prior to March 1, 1913.

No gain or loss is recognized in the case of property acquired before March 1, 1913, and sold or disposed of at less than cost but at more than its fair market value as of that date.

Cost.	Fair market value March 1, 1913.	Sale price.	
\$10,000	\$3,000	5,000	No taxable gain or deductible loss. Reason: A loss on whole transaction, which loss is attributable to period prior to March 1, 1913.

Where the cost is equal to or greater than the fair market value as at March 1, 1913, and the selling price exceeds the cost, the gain to be included in gross income is the excess of the selling price over the cost.

Cost.	Fair market value March 1, 1913.	Sale price.	Taxable gain.
\$10,000	\$5,000	\$20,000	\$10,000. Reason: Gain on whole transaction, all of which is attributable to period subsequent to March 1, 1913.

Where the fair market value as at March 1, 1913, is greater than the cost and the selling price is less than the cost, the deductible loss is the amount by which the cost exceeds the selling price.

Cost.	Fair market value March 1, 1913.	Sale price.	Deductible loss.
\$10,000	\$15,000	\$5,000	\$5,000. Reason: Loss on whole transaction, all of which is attributable to period subsequent to March 1, 1913. Only actual loss sustained deductible.

ART. 1562. Sale of property acquired by gift after December 31, 1920.— In computing the gain or loss from the sale or other disposition of property acquired by gift subsequent to December 31, 1920, the basis shall be the same as it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift. This basis in the hands of the donor or last preceding owner by whom it was not acquired by gift shall be determined under the provisions of article 1561 and the taxable gain or deductible loss from the sale or exchange shall be computed in accordance therewith. If the donee is unable to ascertain the facts necessary to determine such basis, he shall so state upon his return, and the Commissioner shall if possible obtain such facts from such donor or last preceding owner or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be

the value of such property as found by the Commissioner as of the date or approximate date such property was acquired by said donor or last preceding owner. In order to insure a fair and adequate appraisal or determination of the proper basis, donors making gifts of property on or after January 1, 1921, should leave an accessible record of the facts necessary to determine the cost of such property (and its fair market value as of March 1, 1913, where pertinent).

ART. 1563. **Sale of property acquired by gift on or before December 31, 1920, or by bequest, devise, or inheritance.**—In computing the gain or loss from the sale or other disposition of property acquired by gift on or before December 31, 1920, or by bequest, devise, or inheritance, the basis shall be the fair market price or value of such property at the time of acquisition. The term “property acquired by bequest, devise, or inheritance” as used herein includes (a) such property interests as the taxpayer has received as the result of a transfer, or creation of a trust, in contemplation of or intended to take effect in possession or enjoyment at or after death and, (b) such property interests as the taxpayer has received as the result of the exercise by a person of a general power of appointment (1) by will, or (2) by deed executed in contemplation of or intended to take effect in possession or enjoyment at or after his death. See further section 402 (c) and (e) and Regulations 63, articles 17–21, 24 and 25. In the case of property acquired by gift, bequest, devise, or inheritance, prior to March 1, 1913, the taxable gain or deductible loss from the sale or other disposition thereof shall be computed in accordance with article 1561. In the case of property acquired by bequest, devise, or inheritance, 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 shall be deemed to be its fair market value when acquired.

ART. 1564. **Exchange of property.**—Gain or loss arising from the acquisition and subsequent disposition of property is realized only when as the result of a transaction between the owner and another person the property is converted into other property (a) that is essentially different from the property disposed of, and (b) that has a readily realizable market value. Property has a readily realizable market value if it can be readily converted into an amount of cash or its equivalent substantially equal to the fair value of the property. In other words, the property received in exchange must be readily marketable at substantially its fair value in order that a gain or loss be recognized. Property which is regularly traded in a public market has a readily realizable market value in the quantities regularly traded in. Property may be salable, as in the case of a forced sale or in exceptional quantities, without having a readily realizable market value. Stock in a close corporation may or may not have

a readily realizable market value, depending upon all the facts in each particular case. The question whether property has a readily realizable market value, and if so the amount thereof, is one of fact to be determined in each case in the light of all the surrounding circumstances; and attention should be called in the return to each exchange effected during the taxable year about which there could be any doubt.

ART. 1565. Determination of gain or loss from the exchange of property.—The amount of income derived or loss sustained from an exchange of property is the difference between the fair market value (if readily realizable) at the time of the exchange of the property received in exchange and the original cost, or other basis, of the property exchanged. If the property exchanged was acquired prior to March 1, 1913, see article 1561.

ART. 1566. Exchange of property which results in no gain or loss.—Where property is exchanged for other property, even if the property received in exchange has a readily realizable market value, no gain or loss is recognized:

(a) Where property held for investment is exchanged for other property of a like kind, or where property held for productive use in trade or business is exchanged for other property of a like use. The words "like kind" are defined as having reference to the nature or character of the property and not its grade or quality. Therefore under this paragraph no gain or loss is realized by one other than a dealer from the exchange of real estate for real estate, or from the exchange of evidences of indebtedness (such as bonds and notes) for evidences of indebtedness, or from the exchange of shares of stock for other shares of stock; but one kind or class of property may not, under this paragraph, be exchanged for property of a different kind or class, as shares of stock for bonds, or real estate for personal property. Where evidences of indebtedness are exchanged for other evidences of indebtedness, the fact that any of the evidences of indebtedness involved in such exchange are secured by mortgage or other lien, or the fact that any real estate involved in an exchange is improved or unimproved makes no difference, for such facts relate only to grade or quality of the property and not to its kind or class. There is excluded from the provisions of this paragraph stock-in-trade or other property held primarily for sale. Unproductive real estate held by one other than a dealer, for future use or future realization of the increment in value, is held for investment and not primarily for sale.

(b) When in the reorganization of one or more corporations a person receives in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization. The word "reorganization" as used in this paragraph in-

cludes a merger or consolidation (including the acquisition by one corporation of at least a majority of the outstanding voting stock and at least a majority of the total number of outstanding shares of all other classes of stock of another corporation, or of substantially all the properties of another corporation), recapitalization, or mere change in identity, form, or place of organization of a corporation, however effected. Under this paragraph it makes no difference whether the stock or securities received are or are not of a like kind or class. So long as the property received in the reorganization consists of stock or securities within the usual meaning and acceptance of these terms, no gain or loss is recognized. Where two or more corporations unite their properties, by either (1) the dissolution of corporation B and the sale of its assets to corporation A, or (2) the sale of its property by B to A, or (3) the sale of the stock of B to A, or (4) the merger of B into A, or (5) the consolidation of A and B, or (6) the acquisition by A of a majority of the voting stock and a majority of the total number of shares of all other classes of stock of B or of substantially all of the properties of B, no taxable income is received from the transaction by A or B or by the stockholders of either corporation A or corporation B, provided the sole consideration received by the stockholders is stock or securities of corporations A or B or any corporation a party to or resulting from the reorganization. Where in connection with an internal adjustment of the affairs of a corporation, either by recapitalization or a change in identity, form, or domicile (however effected), a person receives in place of the stock or securities owned by him new stock or securities of the corporation, no gain or loss is realized. In this connection, see article 1568.

(c) When (A) a person transfers any property, real, personal, or mixed, to a corporation, and immediately after the transfer is in control of such corporation, or (B) two or more persons transfer any such property to a corporation, and immediately after the transfer are in control of such corporation, and the amounts of stock, securities, or both, received by such persons are in substantially the same proportion as their interests in the property before such transfer. For the purposes of this paragraph, a person is, or two or more persons are, "in control" of a corporation when owning at least 80 per cent of the outstanding voting stock and at least 80 per cent of the total number of outstanding shares of all other classes of stock of the corporation.

Examples.—(1) A and B each own an undivided one-half interest in certain property. Corporation X is created, to which A and B transfer the property, each receiving in exchange therefor 50 per cent of the stock of the corporation X. No gain or loss is realized from this exchange.

(2) A, who owns common stock in the X corporation of the par value of \$70,000, transfers certain property to the corporation, for which he received additional common stock of the par value of \$15,000. The X corporation has outstanding immediately after the transfer only common stock of the par value of \$100,000. No gain or loss is realized from this exchange.

(3) A owns certain property which he transfers to the corporation X, a going concern, in which he owns common stock of the par value of \$280,000 and class A nonvoting preferred stock of the par value of \$190,000. A receives in exchange for the property common stock of the par value of \$70,000. The X corporation immediately after the transfer has outstanding common stock of the par value of \$400,000, class A nonvoting preferred stock of the par value of \$200,000 and class B nonvoting preferred stock of the par value of \$25,000. No gain or loss is realized from this exchange.

(4) A owns certain property which he transfers to corporation X, a going concern, in which A owns no stock, in exchange for common stock of the corporation of the par value of \$170,000. The X corporation has outstanding immediately after the transfer common stock of the par value of \$200,000 and nonvoting preferred stock of the par value of \$50,000. A realized a gain or loss from this exchange measured by the difference between the basis of the property exchanged and the fair market value, if readily realizable, of the stock received in the exchange. If the property exchanged was acquired prior to March 1, 1913, see article 1561.

ART. 1567. Gain or loss from subsequent sale.—(a) Where property is exchanged for other property and no gain or loss is recognized under articles 1564 or 1566 the property received shall for the purpose of determining gain or loss from its subsequent sale be treated as taking the place of the property exchanged therefor. But see article 1568. For exchange of property acquired prior to March 1, 1913, see article 1561. If property is exchanged for two kinds of property and no gain or loss is recognized under articles 1564 or 1566 the cost of the original property should be apportioned, if possible, between the two kinds of property received in exchange for the purpose of determining gain or loss upon subsequent sale. If no fair apportionment is practicable, no profit on any subsequent sale of any part of the property received in exchange is realized until out of the proceeds of sale shall have been recovered the entire cost of the original property. When securities of a single class are exchanged for new securities of different classes so that no gain or loss is realized under the provisions of paragraph (b) of article 1566, for the purpose of determining gain or loss on the subsequent sale of any of the new securities the proportion of the original cost, or other

basis, 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 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.

(b) Where property is compulsorily or involuntarily converted into cash or its equivalent in the manner described in sections 214(a)(12) and 234(a)(14) and the taxpayer proceeds in good faith to expend or set aside the proceeds of such conversion in the form and in the manner therein provided, the property acquired shall for the purpose of determining gain or loss from its subsequent sale be treated as taking the place of a like proportion of the property converted. See articles 261-263.

(c) Where no deduction is allowed by sections 214(a)(5) and 234(a)(4) for total or partial loss on sale or exchange of securities, that part of the securities acquired with relation to which such loss is disallowed shall for the purpose of computing gain or loss from a subsequent sale be treated as taking the place of the securities sold or disposed of. See article 147.

ART. 1568. Exchanges of property for other property and money.—Where property is exchanged for other property which has no readily realizable market value, together with money or other property which has a readily realizable market value, then the money or the fair market value of the property having such readily realizable market value received in exchange shall be applied against and reduce the basis, described in articles 1561, 1562, and 1563, of the property exchanged, and if in excess of such basis, shall be taxable to the extent of the excess; but when property is exchanged for property specified in paragraphs (a), (b), and (c) of article 1566 as received in exchange, together with money or other property of a readily realizable market value other than that specified in such paragraphs, the money or the fair market value of such other property received in exchange shall be applied against and reduce the basis (described in articles

1561, 1562, and 1563) of the property exchanged, and if in excess of such basis shall be taxable to the extent of the excess.

Examples.—(1) A exchanged certain property which he had purchased subsequent to March 1, 1913, for \$5,000, for real estate having no readily realizable market value and \$2,000 in cash. No gain or loss is realized from such exchange. However, if A subsequently sells the real estate, the difference between the amount realized therefor and \$3,000, the basis of the property exchanged reduced by the amount of cash received in the exchange, is taxable gain or deductible loss, as the case may be. See also article 1564.

(2) A exchanged certain property which he had purchased subsequent to March 1, 1913, for \$14,000, for stock having no readily realizable market value and bonds having a readily realizable market value of \$16,000. A realized a taxable gain of \$2,000, the amount by which the fair market value of the bonds exceeds the cost of the property exchanged. The entire amount received from the subsequent sale of the stock received in the exchange constitutes taxable income. See also article 1564.

(3) A, in connection with a reorganization of a corporation, received in place of stock purchased by him subsequent to March 1, 1913, for \$9,000, stock in a corporation a party to the reorganization together with cash in the amount of \$4,000. No gain or loss is realized from the exchange. However, if A subsequently sells the stock, the difference between the amount received therefor and \$5,000, the basis of the old stock reduced by the amount of cash received in the exchange, constitutes taxable gain or deductible loss, as the case may be. See also article 1566.

(4) A transferred to a corporation, all of the outstanding stock of which was owned by him, property purchased by him subsequent to March 1, 1913, for \$40,000, in exchange for stock and \$50,000 in cash. A realized from the exchange a taxable gain of \$10,000, the amount by which the amount of the cash exceeds the cost of the property transferred. The entire amount received from the subsequent sale of the stock received in the exchange constitutes taxable income. See also article 1566.

It is assumed in the above examples that the property exchanged was not of a kind properly to be included in inventory. If the property exchanged was acquired prior to March 1, 1913, or by gift, devise, bequest, or inheritance, see articles 1561, 1562, and 1563.

ART. 1569. Installment sales.—Nothing in the preceding articles shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received. See articles 42 and 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. 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 in liquidation. See article 1566 (b). 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 1565.

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 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.

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 these 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 article 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 second-hand 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 pur-

chased 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.

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 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. Among such cases are (a) farmers and raisers of live stock (see article 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 article 1587), and retail merchants who use what is known as the "retail method" in ascertaining approximate cost. See article 1588.

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.

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, which ever is lower, or (c) at market value, may make his return upon the basis upon which his accounts are kept; provided that a de-

scription 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.

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, 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" 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.

(3) 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 reflect the income, similar adjustments may be made as at the beginning of the preceding year, and the tax, if any be due, shall be assessed at the rate of tax in effect for such year.

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.

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 mark-downs.

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 of profit based upon an average of his entire business, but should compute and use in valuing his inventory the proper percentages for the respective departments or classes of goods.

NET LOSSES.

SEC. 204. (a) That as used in this section the term "net loss" means only net losses resulting from the operation of any trade or business regularly carried on by the taxpayer (including losses sustained from the sale or other disposition of real estate, machinery, and other capital assets, used in the conduct of such trade or business); and when so resulting means the excess of the deductions allowed by section 214 or 234, as the case may be, over the sum of the following: (1) The gross income of the taxpayer for the taxable year, (2) the amount by which the interest received free from taxation under this title exceeds so much of the interest paid or accrued within the taxable year on indebtedness as is not permitted to be deducted by paragraph (2) of subdivision (a) of section 214 or by paragraph (2) of subdivision (a) of section 234, (3) the amount by which the deductible losses not sustained in such trade or business exceed the taxable gains or profits not derived from such trade or business, (4) amounts received as dividends and allowed as a deduction under paragraph (6) of subdivision (a) of section 234, and (5) so much of the depletion deduction allowed with respect to any mine, oil or gas well as is based upon discovery value in lieu of cost.

(b) If for any taxable year beginning after December 31, 1920, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be deducted from the net income of the taxpayer for the succeeding taxable year; and if such net loss is in excess of the net income for such succeeding taxable year, the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year; the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.

(c) The benefit of this section shall be allowed to the members of a partnership and the beneficiaries of an estate or trust, and to insurance companies subject to the tax imposed by section 243 or 246, under regulations prescribed by the Commissioner with the approval of the Secretary.

(d) If it appears, upon the production of evidence satisfactory to the Commissioner, that a taxpayer having a fiscal year beginning in 1920 and ending in 1921 has sustained a net loss during such fiscal year, such taxpayer shall be entitled to the benefits of this section in respect to the same proportion of such net loss which the portion of such fiscal year falling within the calendar year 1921 is of the entire fiscal year.

ART. 1601. Net losses, definition and computation.—The term "net loss" as used in the statute means only a net loss resulting from the operation during the taxable year of any trade or business regularly carried on by the taxpayer. Included therein are losses from the sale or other disposition of real estate, machinery, and other capital assets used in the conduct of such trade or business. In order to be entitled to claim an allowance for a "net loss" the taxpayer must have suffered an actual net loss in a trade or business during the taxable year. The amount properly allowable may be neither the loss reflected upon the return filed for the purpose of the income tax

nor the net loss shown by the taxpayer's profit and loss account, but is to be computed according to the statute, as follows:

(1) In the case of an individual, it is the amount by which the deductions allowed under section 214, excluding:

(a) the amount by which the deductible losses not sustained in such trade or business exceed the taxable gain or profits not derived from such trade or business;

(b) so much of the depletion deduction with respect to any mine, oil or gas well as represents the excess of value based upon discovery subsequent to February 28, 1913, over cost or value as of March 1, 1913; and

(c) the amount of deductions allowed under section 214 not connected with the trade or business,
exceeds the sum of the following:

(a) the gross income of the taxpayer for the taxable year as computed under section 213; and

(b) the amount by which the interest received free from taxation under the provisions of the Act exceeds so much of the interest paid or accrued within the taxable year on indebtedness as is not allowed as a deduction under section 214 (a) (2).

(2) In the case of a corporation, it is the amount by which the deductions allowed under section 234, excluding:

(a) the amount received as dividends and allowed as a deduction under section 234 (a) (6); and

(b) so much of the depletion deduction with respect to any mine, oil or gas well as represents the excess of value based upon discovery subsequent to February 28, 1913, over cost or value as of March 1, 1913,
exceeds the sum of the following:

(a) the gross income of the taxpayer for the taxable year as computed under section 233; and

(b) the amount by which the interest received free from taxation under the provisions of the Act exceeds so much of the interest paid or accrued within the taxable year on indebtedness as is not allowed as a deduction under section 234 (a) (2).

In computing statutory "net loss" the following restrictions are to be noted:

(1) Interest received by the taxpayer on obligations or securities, the interest from which is exempted from taxation must be included in income, but this amount may first be reduced by the amount of any interest paid by the taxpayer on money used to purchase or carry such obligations or securities.

(2) Where depletion is computed upon the basis of discovery value in lieu of cost or value as of March 1, 1913, in making the computation, the deductions are reduced by that portion of the de-

pletion representing the excess of the discovery value over actual cost or value as of March 1, 1913. See section 214 (a) (10) and articles 201-237.

ART. 1602. Claim for allowance of net loss.—A taxpayer sustaining a “net loss” such as set forth in section 204, for any taxable year ending after December 31, 1920, may file a claim therefor with his return for the subsequent taxable year. Such claim should contain a concise statement setting forth the amount of the net loss and all pertinent facts relative thereto, including a schedule showing computation of the net loss in accordance with section 204 and articles 1601 and 1605 of these regulations. If the evidence furnished satisfies the Commissioner that the taxpayer has sustained a “net loss” the amount of such net loss may be deducted from the net income of the taxpayer for the succeeding taxable year and if such net loss is in excess of the net income for such succeeding taxable year the amount of such excess shall be carried over and credited against the net income for the next succeeding taxable year.

ART. 1603. Net losses of partnerships, trusts, estates, and insurance companies.—The provisions of section 204 shall be applied to members of a partnership and the beneficiaries of an estate or trust, provided such partnership, estate, or trust is carrying on a trade or business. See sections 218 and 219. Insurance companies carrying on business and subject to the tax imposed by section 243 or section 246 likewise are allowed the benefits of section 204.

ART. 1604. Net losses, for what periods allowed.—The provisions of section 204, relative to net losses are not retroactive and apply only to taxable years beginning after December 31, 1920, with the following exception: Where a taxpayer has a fiscal year beginning in 1920 and ending in 1921, if the taxpayer produces evidence showing to the satisfaction of the Commissioner that a “net loss” has been sustained during such fiscal year, the benefits of section 204 shall apply to the same proportion of such net loss as the portion of such fiscal year falling within the calendar year 1921 is of the entire fiscal year. The net loss shall be first computed as prescribed in articles 1601 and 1605 for the entire fiscal year ending in 1921 in accordance with this Act as in effect on January 1, 1921. The net loss allowable shall be the same proportion of the net loss for the entire fiscal year as the portion of the fiscal year falling within the calendar year 1921 is of the entire fiscal year.

ART. 1605. Illustration of computation of net loss.—The method of computation of net losses as outlined in article 1601 may be illustrated as follows: A, an individual conducting a trade or business, finds the following facts relative to a taxable year:

(a) His deductions as computed under section 214 amount to \$100,000.

(b) Included in the deductions is an item of \$10,000 for loss by fire of property occupied by him as a residence and not used in connection with his trade or business.

(c) Deductible losses on account of transactions entered into for profit outside of the trade or business are \$3,000.

(d) Taxable gains from transactions entered into for profit and not connected with the trade or business are \$5,000.

(e) Donations to the Red Cross are included in the deductions in the amount of \$1,000.

(f) Depletion is claimed in the amount of \$2,000, of which \$500 is based upon the value of the mineral in the mine as of March 1, 1913, and \$1,500 is attributable to increase in valuation on account of discovery subsequent to February 28, 1913.

(g) His entire gross income as computed under section 213 is \$50,000.

(h) Interest received from municipal bonds exempted from taxation by section 213(b) (4) amounted to \$10,000.

(i) Interest was paid upon money borrowed to carry municipal bonds in the amount of \$8,000, which amount is not deductible in accordance with section 214(a) (2) :

Total deductions (a).....	\$100,000		
Deduct:			
Loss by fire (b).....	\$10,000		
Other losses (c)	3,000		
Total loss outside business	13,000		
Less: Gain outside business (d).....	5,000		
Excess of deductible losses not sustained in trade or business over taxable gains or profits not derived from such trade or business.....	8,000		
Donations (e)	1,000		
Depletion on basis of value after discovery (f).....	\$2,000		
Less: Portion based on value as of Mar. 1, 1913.....	500		
Portion of depletion representing discovery value in excess of cost or value as of Mar. 1, 1913	1,500		
Total exclusion from deductions.....	10,500		
Total expenses directly attributable to the conduct of the trade or business.....	\$89,500		
Gross income (g).....	\$50,000		
Add: Nontaxable interest received (h).....	\$10,000		
Less: Interest paid on money borrowed to carry municipal bonds (i).....	8,000	2,000	52,000
Statutory net loss.....			\$37,500

FISCAL YEARS 1920-1921 AND 1921-1922.

SEC. 205. (a) That if a taxpayer makes return for a fiscal year beginning in 1920 and ending in 1921, his tax under this title for the taxable year 1921 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 1918 at the rates for the calendar year 1920 which the portion of such period falling within the calendar year 1920 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 1921, which the portion of such period falling within the calendar year 1921 is of the entire period.

Any amount paid before or after the passage of this Act on account of the tax imposed for such fiscal year by Title II of the Revenue Act of 1918 shall be credited toward 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, the excess shall be credited or refunded in accordance with the provisions of section 252.

(b) If a taxpayer makes return for a fiscal year beginning in 1921 and ending in 1922, his tax under this title for the taxable year 1922 shall be the sum of: (1) The same proportion of a tax for the entire period computed under this title (as in force on December 31, 1921) at the rates for the calendar year 1921 which the portion of such period falling within the calendar year 1921 is of the entire period, and (2) the same proportion of a tax for the entire period computed under this title (as in force on January 1, 1922) at the rates for the calendar year 1922 which the portion of such period falling within the calendar year 1922 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 (2).

(c) If a fiscal year of a partnership begins in 1920 and ends in 1921, or begins in 1921 and ends in 1922, then (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.

ART. 1621. Fiscal years 1920-1921 and 1921-1922.—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 1920 and ending in 1921, applies to corporations, not including personal service corporations, and to individuals. Subdivision (b), which deals with fiscal years beginning in 1921 and ending in 1922, applies to corporations, including personal service corporations, and to individuals. Subdivision (c), which deals with fiscal years beginning in 1920 or 1921 and ending in 1921 or 1922, applies to

partnerships and to personal service corporations. See as to partnerships, articles 331-335, and as to personal service corporations articles 336-339.

ART. 1622. Fiscal year ending in 1921.—The method provided for computing the tax for a fiscal year beginning in 1920 and ending in 1921, is as follows: (a) The tax attributable to the calendar year 1920 is found by computing the income of the taxpayer and the tax thereon in accordance with Title II of the Revenue Act of 1918 as if the fiscal year was the calendar year 1920, and determining the proportion of such tax which the portion of such period falling within the calendar year 1920 is of the entire period; (b) the tax attributable to the calendar year 1921 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 1921, and determining the proportion of such tax which the portion of such period falling within the calendar year 1921 is of the entire period; and (c) the tax for the fiscal year is found by adding the tax attributable to the calendar year 1920 and the tax attributable to the calendar year 1921.

ART. 1623. Credits in the case of fiscal year ending in 1921.—In computing the tax attributable to the calendar year 1920 the net income computed for the entire period under Title II of the Revenue Act of 1918 shall be credited with the amount of the excess-profits tax computed for the entire period under Title III of the Revenue Act of 1918. In computing the tax attributable to the calendar year 1921 the net income computed for the entire period under the present statute shall be credited with the amount of the excess-profits tax computed for the entire period under Title III of this statute. 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 ending in 1922.—In computing the tax for a fiscal year beginning in 1921 and ending in 1922 the procedure is as follows: (a) The tax attributable to the calendar year 1921 is found by computing the income of the taxpayer and the tax thereon in accordance with the statute as in force on December 31, 1921, as if the fiscal year was the calendar year 1921 and determining the proportion of such tax which the portion of such period within the calendar year 1921 is of the entire period; before calculating the tax the net income computed for the entire period shall be credited with the excess-profits tax computed for the entire period under Title III of this statute as if the fiscal year was the calendar year 1921; (b)

the tax attributable to the calendar year 1922 is found by computing the income of the taxpayer and the tax thereon in accordance with the statute as in force on January 1, 1922, as if the fiscal year was the calendar year 1922, and determining the proportion of such tax which the portion of such fiscal year falling within the calendar year 1922 is of the entire period; and (c) the tax for the fiscal year is found by adding the tax attributable to the calendar year 1921 to the tax attributable to the calendar year 1922. See section 236 of the statute and article 591.

CAPITAL GAIN.

SEC. 206. (a) That for the purpose of this title:

(1) The term "capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921;

(2) The term "capital loss" means deductible loss resulting from the sale or exchange of capital assets consummated after December 31, 1921;

(3) The term "capital deductions" means such deductions as are allowed under this title for the purpose of computing net income and are properly allocable to or chargeable against items of capital gain as defined in this section;

(4) The term "capital net gain" means the excess of the total amount of capital gain over the sum of the capital deductions and capital losses;

(5) The term "ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions; and

(6) The term "capital assets" as used in this section means property acquired and held by the taxpayer for profit or investment for more than two years (whether or not connected with his trade or business), but does not include property held for the personal use or consumption of the taxpayer or his family, or stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year.

(b) In the case of any taxpayer (other than a corporation) who for any taxable year derives a capital net gain, there shall (at the election of the taxpayer) be levied, collected and paid, in lieu of the taxes imposed by sections 210 and 211 of this title, a tax determined as follows:

A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner provided in sections 210 and 211, and the total tax shall be this amount plus 12½ per centum of the capital net gain; but if the taxpayer elects to be taxed under this section the total tax shall in no such case be less than 12½ per centum of the total net income. The total tax thus determined shall be computed, collected and paid in the same manner, at the same time and subject to the same provisions of law, including penalties, as other taxes under this title.

(c) In the case of a partnership or of an estate or trust, the proper part of each share of the net income which consists, respectively, of

ordinary net income and capital net gain, shall be determined under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary, and shall be separately shown in the return of the partnership or estate or trust, and shall be taxed to the member or beneficiary or to the estate or trust as provided in sections 218 and 219, but at the rates and in the manner provided in subdivision (b) of this section.

ART. 1651. Definition and illustration of capital net gain.—(a) Section 206 applies only to sales or exchanges of capital assets consummated after December 31, 1921. It provides that any taxpayer other than a corporation may, if he so desires, state separately in his return his net gain on sales or exchanges of capital assets and pay on such capital net gain (as defined and limited in the section) a flat tax of $12\frac{1}{2}$ per cent in lieu of the tax he would otherwise pay on such income under sections 210 and 211. On his net income from other sources, termed "ordinary net income" in this section, he would be taxed under those sections. If, however, he elects thus to segregate his capital net gain, his total tax on the aggregate amount of both kinds of income must be at least $12\frac{1}{2}$ per cent thereof. The term "capital assets" is defined to mean property of any kind whatever acquired and held by the taxpayer for profit or investment for more than two years, whether or not connected with his trade or business, not including property (for example, a dwelling) held for the personal use or consumption of the taxpayer or his family, or stock in trade of the taxpayer or other property of a kind properly included in an inventory. The specific property sold or exchanged must have been held for more than two years, but in the case of a stock dividend the prescribed period applies to the original stock and the stock received as a dividend considered as a unit and where property is exchanged for other property and no gain or loss recognized under the provisions of section 202, the prescribed period applies to the property exchanged and the property received in exchange considered as a unit. "Capital gain" is taxable gain from the sale or exchange of capital assets, while "capital loss" is deductible loss resulting from the sale of capital assets. As to the basis for determining such gain or loss (including adjustment for depreciation) see article 1561; as to betterments and repairs, see articles 24 (3) and 103. Ordinary repairs and taxes are annual charges against income, and do not enter into the computation of such gain or loss. "Capital deductions" are deductions properly allocable to or chargeable against items of capital gain, including items of expense connected with the sale or exchange of a capital asset (for example, commissions paid brokers or agents). While interest, taxes, and other carrying charges are usually annual charges against income, they may be allocated to capital gain derived from the sale or exchange of a capital asset

for the taxable year in which such asset is sold or exchanged to the extent that such current charges exceed the income directly derived from such asset. "Capital net gain" is the excess of the total amount of the capital gain over the sum of the capital deductions and capital losses. For illustration: A in 1922 sold (1) an office building for \$1,000,000 which he had bought in 1915 for \$500,000 and on which there was depreciation aggregating \$100,000; and (2) stock in a mining company for \$10,000 which he had purchased in 1919 for \$20,000. Taking no account of capital deductions (for example, commissions paid on these sales), his capital gain would be \$600,000, his capital loss \$10,000, and his capital net gain \$590,000. Suppose that his other net income ("ordinary net income") in 1922 was \$50,000. Instead of paying normal tax and surtax on his total net income of \$640,000, he may segregate these capital transactions in his return and pay a tax of 12½ per cent on his capital net gain of \$590,000, plus the normal tax and surtax upon his ordinary net income of \$50,000. Suppose, on the other hand, that A, with capital net gain of \$590,000, not only had no "ordinary net income," but actually sustained a net loss of \$50,000 in his business. He may not deduct such net loss in "ordinary net income" from his capital net gain if he elects to be taxed under section 206, but must pay 12½ per cent of \$590,000.

(b) The credit allowed by section 222 (see articles 381-386) is a credit against the total tax, however computed, but the credits allowed by section 216 are allowed "for the purpose of the normal tax only" and may not be taken against capital net gain, although they may be deducted from "ordinary net income." For example, if B, a married person, had capital net gain of \$30,000 and ordinary net income of \$2,000; his \$2,500 personal exemption would more than offset his ordinary net income, but he may not apply any part of it to reduce his capital net gain. Section 206(b) provides that if the taxpayer elects to be taxed under that section his total tax shall in no case be less than 12½ per cent of his total net income. In the example just given, the tax on B's capital net gain of \$30,000 at 12½ per cent would be \$3,750, but the corrected amount of his total tax under this limitation is 12½ per cent of his total net income of \$32,000, or \$4,000. It will be found, however, that B, with ordinary net income of \$2,000 and capital net gain of \$30,000, would not elect to be taxed under section 206 because under the surtax rates for 1922 his total tax computed in the usual way would be only \$3,940 (normal tax \$2,240 plus surtax \$1,700), or \$60 less than if computed under section 206.

(c) A nonresident alien individual, or a citizen entitled to the benefits of section 262 may elect to be taxed under section 206 with

respect to sales or exchanges of property located within the United States, subject to the limitation that his total tax may not be less than $12\frac{1}{2}$ per cent of his total net income from sources within the United States.

ART. 1652. Returns of capital net gain.—Segregation of capital transactions for the purposes of section 206 is required only where the taxpayer elects to be taxed under that section. Where his total income tax for any taxable year does not exceed $12\frac{1}{2}$ per cent of his net income he will not elect to be so taxed for that year. See article 1651. When a taxpayer elects to be taxed under this section for any taxable year, he shall attach to his return of income for such year an accurate statement under oath showing all items of capital gain, capital loss, and capital deductions in such manner as will clearly show the exact amount of his capital net gain for the taxable year. Each capital transaction must be separately shown and the capital items with respect thereto grouped together in order that the capital gain derived or the capital loss sustained from each capital transaction will readily appear. In the case of sales or exchanges of real estate, the statement must show whether or not it was held as a residence by the taxpayer or his family. In the case of sales or exchanges of securities or any other property, the statement must show how long the property was held by the taxpayer immediately preceding the sale or exchange.

ART. 1653. Partnerships, estates, and trusts.—Under subdivision (c) of section 206 the members of a partnership shall be taxed as provided in section 218, but with respect to any capital net gain, may elect to be taxed as provided in section 206. Similarly estates or trusts or the beneficiaries thereof shall be taxed as provided in section 219, but with respect to any capital net gain may elect to be taxed as provided in section 206. In all cases, however, of election to be taxed under section 206 the minimum tax on the total net income (ordinary net income plus capital net gain) is $12\frac{1}{2}$ per cent. Where the net income of a partnership, estate, or trust consists in whole or in part of capital net gain, there shall be attached to the return, upon the request of any member or beneficiary (or without such request) at the election of a fiduciary of an estate, a statement showing (1) all items of capital gain, capital loss, and capital deductions, as provided in article 1652, and (2) the names of members or beneficiaries and the amounts of their respective shares in such capital net gain.

ADMINISTRATIVE REVIEW.

SEC. 1313. That in the absence of fraud or mistake in mathematical calculation, the findings of facts in and the decision of the Commissioner upon (or in case the Secretary is authorized to approve the same, then after such approval) the merits of any claim presented

under or authorized by the internal-revenue laws shall not be subject to review by any other administrative officer, employee, or agent of the United States.

UNNECESSARY EXAMINATIONS.

SEC. 1309. That no taxpayer shall be subjected to unnecessary examinations or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Commissioner, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

TAX SIMPLIFICATION BOARD.

SEC. 1327. (a) That there is hereby established in the Department of the Treasury a board to be known as the "Tax Simplification Board" (hereinafter in this section called the "Board"), to be composed as follows:

(1) Three members who shall represent the public, to be appointed by the President; and

(2) Three members who shall represent the Bureau of Internal Revenue and shall be officers or employees of the United States serving in such Bureau, to be appointed by the Secretary.

(b) Any vacancy in the Board shall be filled in the same manner as the original appointment. The members representing the public shall serve without compensation except reimbursement for traveling, subsistence, and other necessary expenses incurred in the performance of the duties vested in them by this section. The members representing the Bureau of Internal Revenue shall serve without compensation in addition to that received for their service in such Bureau.

(c) The Secretary shall furnish the Board with such clerical assistance, quarters, and stationery, furniture, office equipment, and other supplies as may be necessary for the performance of the duties vested in them by this section.

(d) It shall be the duty of the Board to investigate the procedure of and the forms used by the Bureau in the administration of the internal revenue laws, and to make recommendations in respect to the simplification thereof. The Board shall make a report to the Congress on or before the first Monday of December in each year.

(e) The expenditures of the Board shall be paid upon vouchers approved by the Board and signed by the chairman thereof. For the expenditures of the Board for the fiscal year ending June 30, 1922, there is authorized to be appropriated, out of any money in the Treasury not otherwise appropriated, the sum of \$10,000.

(f) The Board shall cease to exist on December 31, 1924.

LAWS MADE APPLICABLE—RETURNS—EXAMINATION OF BOOKS AND WITNESSES.

SEC. 1300. 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 state-

ments and returns, and shall comply with such regulations as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

SEC. 1307. That 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.

SEC. 1308. That 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 taxes.**—In collecting the income, 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 specific records, to render returns and statements as directed, to submit himself and his books to examination, and to prepare such regulations as may be prescribed. Section 3165 of the Revised Statutes as amended by section 1311 of the Revenue Act of 1921 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 and 250 of the statute and articles 451 and 1002.

FRACTIONAL PARTS OF A CENT.

SEC. 1306. 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 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 1 cent. Fractional parts of a cent should not be disregarded in the computation of taxes.

PAYMENT OF TAXES BY CHECK OR UNITED STATES SECURITIES.

SEC. 1325. That collectors may receive, at par with an adjustment for accrued interest, notes or 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 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; 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 due on June 15, 1922; series TS-1922, dated September 15, 1921, TS2, 1922, dated November 1, 1921, both maturing on September 15, 1922, in payment of income and profits taxes payable on September 15, 1922; and TD-1922, dated December 15, 1921, maturing on 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. 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.

ART. 1732. Procedure with respect to certificates of indebtedness.— 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 bank, 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.

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 depository 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 depository 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 depository 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 COURTS.

SEC. 1310. (a) 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.

(b) 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.

(c) Paragraph Twentieth of section 24 of the Judicial Code is amended by adding at the end thereof the following new paragraph:

“Concurrent with the Court of Claims of any suit or proceeding, commenced after the passage of the Revenue Act of 1921, for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected, under the internal-revenue laws, even if the claim exceeds \$10,000, if the collector of internal revenue by whom such tax, penalty, or sum was collected is dead at the time such suit or proceeding is commenced.”

DEPOSIT OF UNITED STATES BONDS OR NOTES IN LIEU OF SURETY.

SEC. 1829. 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 or notes 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 or notes 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 or notes 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 or notes deposited hereunder and such other United States bonds or notes as may be substituted therefor from time to time as such security, may be deposited with the Treasurer of the United States, a Federal reserve bank, or other depository duly designated for that purpose by the Secretary, which shall issue receipt therefor, describing such bonds or notes so deposited. As soon as security for the performance of such penal bond is no longer necessary, such bonds or notes 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 or notes 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 notes 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 or notes 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.

REPEALS.

SEC. 1400. (a) That the following parts of the Revenue Act of 1918 are repealed, to take effect (except as otherwise provided in this Act) on January 1, 1922, subject to the limitations provided in subdivision (b):

Title II (called "Income Tax") as of January 1, 1921;

Title III (called "War-Profits and Excess-Profits Tax") as of January 1, 1921;

Title IV (called "Estate Tax") on the passage of this Act;

Title V (called "Tax on Transportation and Other Facilities, and on Insurance");

Sections 628, 629, and 630 of Title VI (being the taxes on soft drinks, ice cream, and similar articles);

Title VII (called "Tax on Cigars, Tobacco and Manufactures Thereof");

Title VIII (called "Tax on Admissions and Dues");

Title IX (called "Excise Taxes");

Title X (called "Special Taxes");

Title XI (called "Stamp Taxes");

Title XII (called "Tax on Employment of Child Labor") as of January 1, 1921; and

Sections 1314, 1315, 1316, 1317, 1319, and 1320 of Title XIII (being certain administrative provisions) on the passage of this Act.

(b) The parts of the Revenue Act of 1918 which are repealed by this Act shall (unless otherwise specifically provided in this Act) remain in force for the assessment and collection of all taxes which have accrued under the Revenue Act of 1918 at the time such parts cease to be in effect, and for the imposition and collection of all penalties or forfeitures which have accrued or may accrue in relation to any such taxes. In the case of any tax imposed by any part of the Revenue Act of 1918 repealed by this Act, 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. The unexpended balance of any appropriation heretofore made and now available for the administration of any such part of the Revenue Act of 1918 shall be available for the administration of this Act or the corresponding provision thereof.

SAVING CLAUSE IN EVENT OF UNCONSTITUTIONALITY.

SEC. 1403. That if any provision of this Act, or the application thereof to any person or circumstances, is held invalid, the remainder of the Act, and the application of such provision to other persons or circumstances, shall not be affected thereby.

CONSOLIDATED RETURNS FOR YEAR 1917.

SEC. 1331.(a) That Title II of the Revenue Act of 1917 shall be construed to impose the taxes therein mentioned upon the basis of consolidated returns of net income and invested capital in the case of domestic corporations and domestic partnerships that were affiliated during the calendar year 1917.

(b) For the purpose of this section a corporation or partnership was affiliated with one or more corporations or partnerships (1) when such corporation or partnership owned directly or controlled through closely affiliated interests or by a nominee or nominees all or substantially all the stock of the other or others, or (2) when substantially all the stock of two or more corporations or the business of two or more partnerships was owned by the same interests: *Provided*, That such corporations or partnerships were engaged in the same or a closely related business, or one corporation or partnership bought from or sold to another corporation or partnership products or services at prices above or below the current market, thus effecting an artificial distribution of profits, or one corporation or partnership in any way so arranged

its financial relationships with another corporation or partnership as to assign to it a disproportionate share of net income or invested capital. For the purposes of this section, public service corporations which (1) were operated independently, (2) were not physically connected or merged and (3) did not receive special permission to make a consolidated return, shall not be construed to have been affiliated; but a railroad or other public utility which was owned by an industrial corporation and was operated as a plant facility or as an integral part of a group organization of affiliated corporations which were required to file a consolidated return, shall be construed to have been affiliated.

(c) The provisions of this section are declaratory of the provisions of Title II of the Revenue Act of 1917.

ART. 1735. Consolidated returns for year 1917.—Section 1331 applies only to the tax levied by the Revenue Act of 1917. See Regulations 41.

ALTERNATIVE TAX ON PERSONAL SERVICE CORPORATIONS.

SEC. 1332. (a) That if either subdivision (e) of section 218 of the Revenue Act of 1918 or subdivision (d) of section 218 of this Act is by final adjudication declared invalid, there shall, in addition to all other taxes, be levied, collected, and paid on the net income (as defined in section 232) received during the calendar years 1918, 1919, 1920, and 1921, by every personal service corporation (as defined in section 200) included within the provisions of such subdivisions, a tax equal to the taxes imposed by Titles II and III of the Revenue Act of 1918 and, in the case of income received during the calendar year 1921, by Titles II and III of this Act.

(b) In such event every such personal service corporation shall, on or before the fifteenth day of the sixth month following the date of entry of decree upon such final adjudication, make a return of any income received during each of the calendar years 1918, 1919, 1920, and 1921 in the manner prescribed by the Revenue Act of 1918 (or in the manner prescribed by this Act, in the case of income received during the calendar year 1921). Such return shall be made and the net income shall be computed on the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in the manner provided for other corporations under the Revenue Act of 1918 and this Act.

(c) If either subdivision (e) of section 218 of the Revenue Act of 1918 or subdivision (d) of section 218 of this Act is so declared invalid, claims for credit or refund of taxes paid under both such sections shall be allowed, if made within the time provided in subdivision (f) of this section.

(d) In case the claims for credit or refund, filed within six months from such date of entry of decree, represent less than 30 per centum of the outstanding stock or shares in the corporation, the amount of taxes imposed by this section upon such corporation shall be reduced to that proportion thereof which the number of stock or shares owned by the shareholders or members making such claims bears to the total number of stock or shares outstanding.

(e) The tax imposed by this section shall be assessed, collected, and paid upon the same basis, in the same manner, and subject to the same provisions of law, including penalties, as the taxes imposed by sections 230 and 301 of the Revenue Act of 1918 (or by sections 230 and 301 of this Act, in the case of income received during the calendar year 1921), but no interest or penalties shall be due or payable thereon for any period prior to the date upon which the return is by this section required to be made and the first installment paid. The amount of tax paid by any shareholder or member of a personal service corporation pursuant to the provisions of subdivision (e) of section 218 of the Revenue Act of 1918 or subdivision (d) of section 218 of this Act shall be credited against the tax due from such corporation under this section upon the joint written application of such corporation and such shareholder or member or his representatives, heirs, or assigns, if such application is filed with the Commissioner within six months from such date of entry of decree.

(f) Notwithstanding any other provision of law, no claim for a credit or refund of taxes paid under subdivision (e) of section 218 of the Revenue Act of 1918 or subdivision (d) of section 218 of this Act, may be filed after the expiration of six months from such date of entry of decree: *Provided, however,* That a personal service corporation of which no shareholder or member has filed such claim within such period of six months shall not be subject to the tax imposed by this section.

ART. 1736. Alternative tax on personal service corporations.—Section 1332 of the statute is an alternative measure and is of no effect unless and until either subdivision (e) of section 218 of the Revenue Act of 1918 or subdivision (d) of section 218 of the statute of 1921 is declared invalid by final adjudication.

STATUTE OF LIMITATIONS—INTERNAL REVENUE LAWS.

SEC. 1321. (a) That the Act entitled "An Act to limit the time within which prosecutions may be instituted against persons charged with violating internal-revenue laws," approved July 5, 1884, is amended to read as follows:

"That no person shall be prosecuted, tried, or punished for any of the various offenses arising under the internal-revenue laws of the United States unless the indictment is found or the information instituted within three years next after the commission of the offense: *Provided,* That the time during which the person committing the offense is absent from the district wherein the same is committed shall not be taken as any part of the time limited by law for the commencement of such proceedings: *Provided further,* That the provisions of this Act shall not apply to offenses committed prior to its passage: *Provided further,* That where a complaint shall be instituted before a commissioner of the United States within the period above limited, the time shall be extended until the discharge of the grand jury at its next session within the district: *And provided further,* That this Act shall not apply to offenses committed by officers of the United States."

(b) Any prosecution or proceeding under an indictment found or information instituted prior to the passage of this Act shall not be affected

in any manner by this amendment, but such prosecution or proceeding shall be subject to the limitations imposed by law prior to the passage of this Act.

RETROACTIVE REGULATIONS.

SEC. 1314. That in case a regulation or Treasury decision relating to the internal-revenue laws made by the Commissioner or the Secretary, or by the Commissioner with the approval of the Secretary, is reversed by a subsequent regulation or Treasury decision, and such reversal is not immediately occasioned or required by a decision of a court of competent jurisdiction, such subsequent regulation or Treasury decision may, in the discretion of the Commissioner, with the approval of the Secretary, be applied without retroactive effect.

RULES AND REGULATIONS.

SEC. 1303. 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.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 15, 1922:

A. W. MELLON,
Secretary of the Treasury.

(T. D. 3296.)

Income tax—Inventories.

Articles 1581–1588, Regulation No. 45 (1920 edition), amended.

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

To Collectors of Internal Revenue and Others Concerned:

Articles 1581–1588, Regulations No. 45 (1920 edition), are amended to read as follows:

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 pos-