

(T. D. 2831.)

Regulations No. 45, relating to the income tax and war profits and excess profits tax under Title II and III of the Revenue Act of 1918. [Public, No. 254, 65th Congress. H. R. 12863.]

PART I.

INCOME TAX ON INDIVIDUALS.

NORMAL TAX.

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

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

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

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

ART. 2. *Normal tax.*—For the calendar year 1918 the normal income tax on individual citizens or residents of the United States is at the rate of 6 per cent upon the first \$4,000 of net income subject to the normal tax and 12 per cent upon the excess over that amount, and for the calendar year 1919 and subsequent years is at the rate of 4 per cent

upon the first \$4,000 and 8 per cent upon the excess over that amount. The lower rate on the first \$4,000 applies to each separate individual, whether married or unmarried, and should not be confused with the joint exemption granted married persons. In the case of nonresident alien individuals the normal tax for 1918 is 12 per cent and for subsequent years 8 per cent. In order to determine the income to which the normal tax is applied, the net income, as defined in section 212 of the statute and articles 21-26 of the regulations, is first entitled to the credits and exemptions specified in section 216 of the statute and articles 301-307.

ART. 3. Persons liable to tax.—Every citizen of the United States, wherever resident, is liable to the tax. It makes no difference that he may own no assets within the United States and may receive no income from sources within the United States. Every resident alien individual is liable to the tax, even though his income is wholly from sources outside the United States. Every nonresident alien individual is liable to the tax on his income from sources within the United States. See section 213 (c) of the statute and articles 91-93. Estates and trusts are also subject to the tax. See section 219 of the statute and articles 341-346.

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, he is presumed to have lost his American citizenship; but this presumption does not apply to residence abroad while the United States is at war. An Italian 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. 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 of citizen or resident alien parents, who has long since moved to a foreign country and established a domicile there, but who has never been naturalized therein or taken an oath of allegiance thereto, is still a citizen of the United States. For the difference between resident alien individuals and nonresident alien individuals see articles 312-315.

SURTAX.

SEC. 211. (a) That, in lieu of the taxes imposed by subdivision (b) of section 1 of the Revenue Act of 1916 and by section 2 of the Revenue Act of 1917, but in addition to the normal tax imposed by section 210 of this Act, there shall be levied, collected, and paid for each taxable

year upon the net income of every individual, a surtax equal to the sum of the following:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Net income.	Per cent.	Surtax.	Total surtax.
\$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
\$86,000 to \$88,000.....	42	840	18, 050
\$88,000 to \$90,000.....	43	860	18, 910
\$90,000 to \$92,000.....	44	880	19, 790
\$92,000 to \$94,000.....	45	900	20, 690
\$94,000 to \$96,000.....	46	920	21, 610
\$96,000 to \$98,000.....	47	940	22, 550
\$98,000 to \$100,000.....	48	960	23, 510
\$100,000 to \$150,000.....	52	26, 000	49, 510
\$150,000 to \$200,000.....	56	28, 000	77, 510
\$200,000 to \$300,000.....	60	60, 000	137, 510
\$300,000 to \$500,000.....	63	126, 000	263, 510
\$500,000 to \$1,000,000.....	64	320, 000	583, 510
\$1,000,000 up.....	65

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

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

income is the portion of the surtax attributable to such sale, and if it exceeds 20 per cent of the selling price of the property such portion of the surtax shall be reduced to that amount. See articles 219-221.

NET INCOME DEFINED.

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

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

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

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

appears from the fact that ordinarily it is to be computed in accordance with the method of accounting regularly employed in keeping the books of the taxpayer. As to the net income of corporations see section 232 and article 531.

ART. 22. Computation of net income.—Net income must be computed with respect to a fixed period. Usually that period is twelve months and is known as the taxable year. Items of income and of expenditures which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. 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.—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) of the statute. A taxpayer is deemed to have received items of gross income which have been credited to or set apart for him without restriction. See article 53. On the other hand, appreciation in value of property is not even an accrual of income to a taxpayer prior to the realization of such appreciation through conversion of the property. The return of income shall in every case be made on the basis clearly reflecting the income, including such items of income and deductions as properly would have been included in the return for the preceding taxable year had the present basis been used, but which were not so included, and excluding such items of income and deductions as would have been excluded from the return for the preceding taxable year had the present basis been used, but which were in fact included. A separate statement shall be attached to the return showing in detail all such items and the

reasons why they were excluded or included in the return for the preceding taxable year. If in the opinion of the Commissioner the net effect of such items upon the net income for the taxable year indicates that the returns for any previous years did not approximately reflect the true income for such years, amended returns for such years may be required.

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

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

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

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

ART. 25. Accounting period.—The return of a taxpayer is made and his income computed for his taxable year, which means his fiscal year, or the calendar year if he has not established a fiscal year. The term "fiscal year" means an accounting period of twelve months ending on the last day of any month other than December. No fiscal year will, however, be recognized unless before its close it was definitely established as an accounting period by the taxpayer and the books of such taxpayer were kept in accordance therewith. The taxable year 1918 is the calendar year 1918 or any fiscal year ending during the calendar year 1918. See section 200 of the statute. A taxpayer having an existing accounting period which is a fiscal year within the meaning of the statute not only needs no permission to make his return on the basis of such a taxable year, but is required to do so, regardless of the former basis of rendering returns. A person having no such fiscal year must make return on the basis of the calendar year. The first return under the present statute of a tax-

payer who has heretofore made return on a basis different from his accounting period will necessarily overlap his next previous return. For the method of adjusting the tax in such a case see section 205 of the statute and articles 1621-1624. Section 226 has no application to this situation. Except in the cases of a return for the taxable year 1918 and of a first return for income tax a taxpayer shall make his return on the basis (fiscal or calendar year) upon which he made his return for the taxable year immediately preceding unless, with the approval of the Commissioner, he has changed the basis of computing his net income.

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

GROSS INCOME DEFINED: INCLUSIONS.

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

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, 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 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. Profits derived from sales in foreign commerce are taxable. Income may be in the form of cash or of property. Dividends (other than stock dividends declared before November 1, 1918, and received before March 27, 1919) are taxed at the rates for the year in which paid. See section 201 of the statute and articles 1541-1549. The amount of income tax paid for a bondholder by an obligor pursuant to a tax-free covenant in its bonds is in the nature of additional interest paid the bondholder and must be included in his gross income. He is not, however, entitled to deduct such income tax paid on his behalf. See sections 214 (a) (3) and 221 (b) of the statute and articles 565 and 566. As to the basis for determining gain or loss from sales see section 202 and articles 1561-1570. As to the gross income of corporations see section 233 and articles 541-550.

ART. 32. Compensation for personal services.—Where no determination of compensation is had until the completion of the services, the amount received is income for the calendar year of its determination. Commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips, retired pay of federal and other officers, and pensions or retiring allowances paid by the United States or private persons, are income to the recipients; as are also marriage fees, baptismal offerings, sums paid for saying masses for the dead, and other gifts and contributions received by a clergyman, evangelist or religious worker for services rendered. The salaries of federal officers and employees are subject to tax. But see article 86. See further articles 85 and 105-108.

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

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

ART. 35. Gross income from business.—In the case of a manufacturing, merchandising or mining business "gross income" means the total sales, less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources. In determining the gross income subtractions should not be made for depreciation, depletion, selling expenses or losses, or for items not ordinarily used in computing the cost of goods sold. Gross income includes all amounts received by the taxpayer as allowances for amortization, from whatever source and by whatever name called. The allowance for amortization authorized by the statute must be taken by way of explicit deduction from gross income. See section 214 (a) (9) and articles 181-188. See also article 52.

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

been overstated or understated, the taxpayer should file amended returns for such year or years. See section 212 of the statute and articles 22-24.

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

ART. 38. Gross income of farmers.—All gains, profits and income derived from the sale or exchange of farm products, whether produced on the farm or purchased and resold, shall be included in the return of income for the year in which the products were actually marketed and sold, unless an inventory is used. In case of the sale of machinery, and of animals purchased as draft or work animals or solely for breeding purposes and not for resale, any excess over the cost thereof reduced by all sums theretofore deducted for depreciation shall be included as gross income in preparing the taxpayer's return. Where farm produce is exchanged for merchandise, groceries or mill products, the market value of the article or product received in exchange is to be returned as income. Rents received in crop shares shall be returned as of the year in which the crop shares are reduced to money or a money equivalent. 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 case 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. When live stock purchased is sold, its cost is to be deducted from the sales price in ascertaining the amount of gain or profit to be returned for tax purposes. If, however, an inventory is used, the cost price of the article sold must not be taken as an additional deduction in the return of income, as such cost price will be reflected in the inventory. 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. See further articles 110, 145 and 171.

ART. 39. Sale of stock and rights.—When shares of stock in a corporation are sold from lots purchased at different times and at different prices and the identity of the lots can not be determined, the stock sold shall be charged against the earliest purchases of such stock. The excess of the amount realized on the sale over the cost of the stock, or its fair market value as of March 1, 1913, if purchased before that date, will be the profit to be accounted for as income. In the case of stock received as a stock dividend, whether or not paid out of earnings or profits accrued since February 28, 1913, and in the case of stock in respect of which any such dividend was paid, the cost of each share of such stock shall be ascertained as specified in article 1547. Where common stock is received as a bonus with the purchase of preferred stock or bonds, the total purchase price shall be fairly apportioned between the stock and securities purchased for the purpose of determining the portion of the consideration attributable to each class of stock or securities and so representing its cost, but if that should be impracticable in any case, no profit on any subsequent sale of any part of the stock or securities will be realized until out of the proceeds of sales shall have been recovered the total cost. See article 1565. The entire amount realized from the sale of rights to subscribe for stock is income.

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

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

ART. 42. Sale of personal property on installment plan.—Dealers in personal property ordinarily sell either for cash, or on the personal credit of the buyer, or on the installment plan. Occasionally a fourth type of sale is met with, in which the buyer makes an initial payment of such a substantial nature (for example, a payment of more than 25 per cent) that the sale, though involving deferred payments, is not one on the installment plan. In sales on personal credit, and in the substantial payment type just mentioned, obligations of purchasers are to be regarded as the equivalent of cash, but a different rule applies to sales on the installment plan. Dealers in personal property who sell on the installment plan usually adopt one of four ways of protecting themselves in case of default: (a) through an agreement that title is to remain in the seller until the buyer has completely performed his part of the transaction; (b) by a form of contract in which title is conveyed to the purchaser immediately, but subject to a lien for the unpaid portion of the purchase price; (c) by a present transfer of title to the purchaser, who at the same time executes a reconveyance in the form of a chattel mortgage to the seller; or (d) by conveyance to a trustee pending performance of the contract and subject to its provisions. The general purpose and effect being the same in all of these plans, it is desirable that a uniformly applicable rule be established. The rule prescribed is that in the sale or contract for sale of personal property on the installment plan, whether or not title remains in the vendor until the property is fully paid for, the income to be returned by the vendor will be that proportion of each installment payment which the gross profit to be realized when the property is paid for bears to the gross contract price. Such income may be ascertained by taking that proportion of the total payments received in the taxable year from installment sales (always including payments received in the taxable year on account of sales effected in earlier years as well as those effected in the taxable year) which the gross profit to be realized on the total installment sales made during the taxable year bears to the gross contract price of all such sales made during the taxable year. Where a change is made to this method of computing net income the taxpayer's balance sheet should be adjusted conformably as of the date when the change is effected. If for any reason the vendee defaults in any of his installment payments and the vendor repossesses the property, the entire amount received on installment payments, less the profit 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.

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

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

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

(2) Deferred payment sales not on the installment plan, in which there is a substantial initial payment (ordinarily not less than one-fourth of the purchase price), deferred payments being secured by a mortgage or other lien. Such sales are distinguished from sales on the installment plan by the substantial character of the initial payment and also usually by a relatively small number of deferred payments.

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

ART. 45. Sale of real estate on installment plan.—In the two kinds of transactions included in class (1) in the foregoing article, installment obligations assumed by the buyer are not ordinarily to be regarded as the equivalent of cash, and the vendor may report as his income from such transactions in any year that proportion of each payment actually received in that year which the gross profit to be realized

when the property is paid for bears to the gross contract price. If the return is made on this basis and the vendor repossesses the property after default by the buyer, retaining the previous payments, the entire amount of such payments, less the profit previously returned, will be income to the vendor and will be so returned for the year in which the property was repossessed, and the property repossessed must be included in the inventory at its original cost to himself (less any depreciation as defined in articles 161 and 162). If the taxpayer chooses as a matter of settled practice consistently followed to treat the obligations of the purchaser as equivalent to cash and to report the profit derived from the entire consideration, cash and deferred payments, as income for the year when the sale is made, this is permissible. If so treated the rule prescribed in article 46 will apply.

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

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

ART. 48. Rent and royalties.—When improvements made by a lessee become part of the real estate, the value of such improvements upon the expiration of the existing term of the lease is income to the lessor. In general, sums paid by a tenant for the use of property, although to another than the landlord, are properly to be regarded as rent and constitute income of the landlord. See further article 109. Royalties on patents are income.

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

ART. 50. Replacement fund for loss.—In any case in which the taxpayer elects to replace or restore the lost, damaged or transferred property, but where it is not practicable to do so immediately, he

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

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

ART. 52. When included in gross income.—Gains, profits and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included when they accrue to him in accordance with the approved method of

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

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

ART. 54. Examples of constructive receipt.—Where interest coupons have matured, but have not been cashed, such interest payment, though not collected when due and payable, is nevertheless available

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

GROSS INCOME DEFINED: EXCLUSIONS.

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

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

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

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

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

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

from gross income only if and to the extent it is wholly exempt from taxation to the taxpayer both under this title and under Title III:

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

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

(7) Income derived from any public utility or the exercise of any essential governmental function and accruing to any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, or income accruing to the government of any possession of the United States, or any political subdivision thereof.

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

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

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

ART. 72. Proceeds of insurance.—(a) Upon the death of an insured the proceeds of his life insurance policies, whether paid to his estate or to individual beneficiaries, 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 in-

terest, of premiums paid by him therefor is excluded from his gross income. See article 47. (c) Whether he be alive or dead, the amounts received by an insured or his estate or other beneficiaries through accident or health insurance or under workmen's compensation acts as compensation for personal injuries or sickness are excluded from the gross income of the insured, his estate and other beneficiaries. Any damages recovered by suit or agreement on account of such injuries or sickness are similarly excluded from the gross income of the individual injured or sick, if living, or of his estate or other beneficiaries entitled to receive such damages, if dead. See further article 294. Since June 25, 1918, no assessment of any federal tax may be made on any allotments, family allowances, compensation, or death or disability insurance payable under the War Risk Insurance Act of September 2, 1917, as amended, even though the benefit accrued before that date.

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

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

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

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

ART. 77. Interest upon United States obligations.—Although interest upon the obligations of the United States is in general exempt from tax, in the case of such obligations issued after September 1, 1917, which include Treasury certificates of indebtedness, war savings certificates and the liberty bond issues (except the first liberty loan $3\frac{1}{2}$ per cent bonds), the interest is exempt from tax only if and to the extent provided in the acts authorizing the issue thereof, as amended and supplemented. Interest credited to postal savings accounts upon moneys deposited in postal savings banks on or before September 1, 1917, is exempt from income tax, while interest credited upon deposits made subsequently to September 1, 1917, is liable to tax. Interest on the first liberty loan $3\frac{1}{2}$ per cent bonds is entirely exempt from tax, but that absolute exemption does not extend to the bonds of the first liberty loan converted.

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

SEC. 7. That none of the bonds authorized by section one, nor of the certificates authorized by section five, or by section six, of this act, shall bear the circulation privilege. All such bonds and certificates shall be exempt, both as to principal and interest from all taxation now or hereafter imposed by the United States, any State, or any of the pos-

essions of the United States, or by any local taxing authority, except (a) estate or inheritance taxes, and (b) graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations. The interest on an amount of such bonds and certificates the principal of which does not exceed in the aggregate \$5,000, owned by any individual, partnership, association, or corporation, shall be exempt from the taxes provided for in subdivision (b) of this section.

Accordingly, in addition to the interest on first liberty loan $3\frac{1}{2}$ per cent bonds, which is entirely free from 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, together with all interest on United States certificates of indebtedness and war savings certificates, is exempt from the normal tax. Such interest in excess of the interest on not exceeding \$5,000 principal amount of such bonds and certificates may, however, be subject to surtax and to the war profits and excess profits tax and may accordingly require to be included in gross income.

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

That until the expiration of two years after the date of the termination of the war between the United States and the Imperial German Government, as fixed by proclamation of the President—

(1) The interest on an amount of bonds of the Fourth Liberty Loan the principal of which does not exceed \$30,000 owned by any individual, partnership, association, or corporation, shall be exempt from graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations;

(2) The interest received after January 1, 1918, on an amount of bonds of the First Liberty Loan Converted, dated either November 15, 1917, or May 9, 1918, the Second Liberty Loan, converted and unconverted, and the Third Liberty Loan, the principal of which does not exceed \$45,000 in the aggregate, owned by any individual, partnership, association, or corporation, shall be exempt from such taxes: *Pro-*

vided, however, That no owner of such bonds shall be entitled to such exemption in respect to the interest on an aggregate principal amount of such bonds exceeding one and one-half times the principal amount of bonds of the Fourth Liberty Loan originally subscribed for by such owner and still owned by him at the date of his tax return; and

(3) The interest on an amount of bonds, the principal of which does not exceed \$30,000, owned by any individual, partnership, association, or corporation, issued upon conversion of $3\frac{1}{2}$ per centum bonds of the First Liberty Loan in the exercise of any privilege arising as a consequence of the issue of bonds of the Fourth Liberty Loan, shall be exempt from such taxes.

The exemptions provided in this section shall be in addition to the exemption provided in section 7 of the Second Liberty Bond Act in respect to the interest on an amount of bonds and certificates, authorized by such Act and amendments thereto, the principal of which does not exceed in the aggregate \$5,000, and in addition to all other exemptions provided in the Second Liberty Bond Act.

Accordingly, the exemption from surtaxes and war profits and excess profits taxes covers, and there may be excluded from gross income, the interest received on not exceeding \$5,000 principal amount in the aggregate of first liberty loan converted 4 per cent bonds, first liberty loan converted $4\frac{1}{4}$ 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, fourth liberty loan $4\frac{1}{4}$ per cent bonds, and Treasury certificates and war savings certificates, apportioned as the taxpayer may choose; and in addition, until the expiration of two years after the termination of the war, (a) the interest received on not exceeding \$30,000 principal amount of fourth liberty loan $4\frac{1}{4}$ per cent bonds; plus (b) the interest received on an aggregate principal amount of first liberty loan converted 4 per cent bonds, first liberty loan converted $4\frac{1}{4}$ per cent bonds (dated May 9, 1918), second liberty loan bonds, converted and unconverted, and third liberty loan $4\frac{1}{4}$ per cent bonds, not exceeding \$45,000 and not exceeding 150 per cent of the principal amount of bonds of the fourth liberty loan both originally subscribed for by the taxpayer and still owned by him at the date of his return; plus (c) the interest received on not exceeding \$30,000 principal amount of first liberty loan second converted $4\frac{1}{4}$ per cent bonds (dated October 24, 1918).

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

Sec. 2. (a) That until the expiration of five years after the date of the termination of the war between the United States and the German Government, as fixed by proclamation of the President, in addition to the exemptions provided in section 7 of the Second Liberty Bond Act in respect to the interest on an amount of bonds and certificates, authorized by such Act and amendments thereto, the principal of which does not exceed in the aggregate \$5,000, and in addition to all other ex-

emptions provided in the Second Liberty Bond Act or the Supplement to Second Liberty Bond Act, the interest received on and after January 1, 1919, on an amount of bonds of the First Liberty Loan Converted, dated November 15, 1917, May 9, 1918, or October 24, 1918, the Second Liberty Loan converted and unconverted, the Third Liberty Loan, and the Fourth Liberty Loan, the principal of which does not exceed \$30,000 in the aggregate, owned by any individual, partnership, association, or corporation, shall be exempt from graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations.

(b) In addition to the exemption provided in subdivision (a), and in addition to the other exemptions therein referred to, the interest received on and after January 1, 1919, on an amount of the bonds therein specified the principal of which does not exceed \$20,000 in the aggregate, owned by any individual, partnership, association, or corporation, shall be exempt from the taxes therein specified: *Provided*, That no owner of such bonds shall be entitled to such exemption in respect to the interest on an aggregate principal amount of such bonds exceeding three times the principal amount of notes of the Victory Liberty Loan originally subscribed for by such owner and still owned by him at the date of his tax return.

Accordingly, with respect to the interest on liberty bonds received after December 31, 1918, the exemption from surtaxes and war profits and excess profits taxes covers, and there may be excluded from gross income, in addition to the exemptions specified in articles 77, 78 and 79, (a) the interest received on and after January 1, 1919, until the expiration of five years after the termination of the war, on not exceeding \$30,000 principal amount in the aggregate of first liberty loan converted 4 per cent bonds, first liberty loan converted $4\frac{1}{4}$ 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, apportioned as the taxpayer may choose; and in addition (b) the interest received on and after January 1, 1919, during the life of the notes of the victory liberty loan, on an aggregate principal amount of the bonds described in subdivision (a) not exceeding \$20,000 and not exceeding three times the principal amount of notes of the victory liberty loan originally subscribed for by the taxpayer and still owned by him at the date of his return. The specific exemptions of notes of the victory liberty loan will be prescribed by the Secretary of the Treasury pursuant to the Victory Liberty Loan Act.

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

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

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

ART. 83. Income of foreign governments.—The exemption of income of foreign governments applies also to their political subdivisions. Any income collected by foreign governments from investments in the United States in stocks, bonds or other domestic securities, which are not actually owned by but are loaned to such foreign governments, is subject to tax. The income of foreign ambassadors and ministers from investments in bonds and stocks and from interest

on bank balances, and the fees of foreign consuls, are exempt from tax, but income of such foreign officials from any business carried on by them in the United States would be taxable. The compensation of citizens of the United States who are officers or employees of a foreign government is, however, not exempt from tax.

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

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

ART. 86. Compensation of soldiers and sailors.—A person of either sex in active service in the military or naval forces of the United States may exclude from gross income his or her compensation received from the United States up to the amount of \$3,500 in any taxable year, except that this exemption does not apply to compensation received either before or after the present war. The date of the termination of the war for the purpose of the statute will be fixed by proclamation of the President. The military and naval forces of the United States include, among others, army contract surgeons and the individuals named in section 1 of the statute. A person is in active service if he is actually serving in such forces, not necessarily in the field or in the theatre of war, and is not merely on the retired or reserve list. Accordingly, if such a person receives compensation from the United States of \$3,500 or less and

has no other income of an amount sufficient in itself to require him to render a return of income, he need make no return. Members of draft boards are not as such entitled to this exemption.

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

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

turn, and in any case in which the amount subtracted in respect of such stamps or coupons is found to be excessive an amended return or amended returns will be required.

GROSS INCOME DEFINED: NONRESIDENT ALIEN INDIVIDUAL.

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

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

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

ART. 93. Income of nonresident aliens from United States bonds.—By virtue of section 4 of the Victory Liberty Loan Act of March 3, 1919, amending section 3 of the Fourth Liberty Bond Act of July 9, 1918, the interest received on and after March 3, 1919, on bonds, notes

and certificates of indebtedness of the United States, and bonds of the War Finance Corporation, while beneficially owned by a non-resident 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.

DEDUCTIONS ALLOWED: BUSINESS EXPENSES.

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

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

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

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

gross income the total cost of such supplies and materials as were purchased during the year for which the return is made, provided the net income is clearly reflected by this method.

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

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

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

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

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

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

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

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

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

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

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

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

ART. 109. Rentals.—Where a leasehold is acquired for 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 of erecting buildings or permanent improvements on ground leased by a taxpayer is additional rental and is therefore a proper deduction from gross income, provided such buildings and improvements under the terms of the lease revert to the owner of the ground at the expiration of the lease. In such a case the cost will be prorated according to the number of years constituting the term of the lease. The lessee will not be permitted to deduct from gross income any depreciation with respect to such buildings, but the cost of incidental repairs necessary to keep them

in an efficient condition for the purposes of their use may be deducted. If, however, the life of the improvement is less than the life of the lease, depreciation may be taken by the lessee instead of treating the cost as rent. See article 48.

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

ART. 111. When charges deductible.—Each year's return, so far as practicable, both as to gross income and deductions therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. See articles 21-24 and 52. The expenses, liabilities or deficit of one year can not be used to reduce the income of a subsequent year. A

person making returns on an accrual basis has the right to deduct all authorized allowances, whether paid in cash or set up as a liability, and it follows that if he does not within any year pay or accrue certain of his expenses, interest, taxes or other charges, and makes no deduction therefor, he can not deduct from the income of the next or any subsequent year any amounts then paid in liquidation of the previous year's liabilities. A loss from theft or embezzlement occurring in one year and discovered in another is deductible only for the year of its occurrence. Any amount paid pursuant to a judgment or otherwise on account of damages for personal injuries, patent infringement or otherwise, is deductible from gross income when the claim is put in judgment or paid, less any amount of such damages as may have been compensated for by insurance or otherwise. If subsequently to its occurrence, however, a taxpayer first ascertains the amount of a loss sustained during a prior taxable year which has not been deducted from gross income, he may render an amended return for such preceding taxable year, including such amount of loss in the deductions from gross income, and may file a claim for refund of the excess tax paid by reason of the failure to deduct such loss in the original return. See section 252 of the statute and articles 1031-1038.

DEDUCTIONS ALLOWED: INTEREST.

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

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

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

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

DEDUCTIONS ALLOWED: TAXES.

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

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

ART. 131. Taxes.—Federal taxes (except income, war profits and excess profits taxes), State and local taxes (except taxes assessed against local benefits of a kind tending to increase the value of the property assessed), and taxes imposed by possessions of the United States or by foreign countries (except the amount of income, war profits and excess profits taxes allowed as a credit against the tax), are deductible from gross income. See section 222 of the statute and articles 381–384 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 Illinois laws relating to drainage districts are not limited to the property benefited, and assessments so paid are deductible. 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 amounts so paid 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. Where the assessments are made for the purpose of constructing local benefits, the payments by the taxpayer are in the nature of capital expenditures and are not deductible. Where assessments are made for the purpose of both construction and maintenance or repairs, the burden is on the taxpayer to show the allocation of the amounts assessed to the different purposes. If the allocation can not be made, none of the amounts so paid is deductible.

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

DEDUCTIONS ALLOWED: LOSSES.

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

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

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

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

ART. 141. Losses.—Losses sustained during the taxable year and not compensated for by insurance or otherwise are fully deductible (except by nonresident aliens) if (a) incurred in the taxpayer's trade or business, or (b) incurred in any transaction entered into for profit, or (c) arising from fires, storms, shipwreck or other casualty, or from theft. They must usually be evidenced by closed and completed transactions. In the case of the sale of assets the loss will be the difference between the cost thereof, less depreciation sustained since acquisition, or the fair market value as of March 1, 1913, if acquired before that date, less depreciation since sustained, and the price at which they were disposed of. See section 202 of the statute and articles 39-46 and 1561. When the loss is claimed through the destruction of property by fire, flood or other casualty, the amount deductible will be the difference between the cost of the property or its fair market value as of March 1, 1913, and the salvage value thereof, after deducting from the cost or value as of March 1, 1913, the amount, if any, which has been or should have been set aside and deducted in the current year and previous years from gross income on account of depreciation and which has not been paid out in making good the depreciation sustained. But the loss should be reduced by the amount of any insurance or other compensation received. See articles 49 and 50. A loss in the sale of an individual's residence is not deductible. Losses in illegal transactions are not deductible.

ART. 142. Voluntary removal of buildings.—Loss due to the voluntary removal or demolition of old buildings, the scrapping of old machinery, equipment, etc., incident to renewals and replacements will be deductible from gross income in a sum representing the difference between the cost of such property demolished or scrapped and the amount of a reasonable allowance for the depreciation which the property had undergone prior to its demolition or scrapping; that is to say, the deductible loss is only so much of the original cost of the property, less salvage, as would have remained unextinguished had a reasonable allowance been charged off for depreciation during each year prior to its destruction. When a taxpayer buys real estate upon which is located a building which he proceeds to raze with

a view to erecting thereon another building, it will be considered that the taxpayer has sustained no deductible loss by reason of the demolition of the old building, and no deductible expense on account of the cost of such removal, the value of the real estate, exclusive of old improvements, being presumably equal to the purchase price of the land and building plus the cost of removing the useless building.

ART. 143. Loss of useful value.—When through some change in business conditions the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in the business, he may claim as a loss for the year in which he takes such action the difference between the cost or the fair market value as of March 1, 1913, of any asset so discarded (less any depreciation allowances) and its salvage value remaining. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property must be prematurely discarded, as, for example, where machinery or other property must be replaced by a new invention, or 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 181-188.

ART. 144. Shrinkage in securities and stocks.—A person possessing securities, such as stocks and bonds, can not deduct from gross income any amount claimed as a loss on account of the shrinkage in value of such securities through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the securities mature or are disposed of. See, however, article 154. In the case of banks or other corporations which are subject to supervision by State or federal authorities, and which in obedience to the orders of such supervisory officers charge off as losses amounts representing an alleged shrinkage in the value of property, the amounts so charged off do not constitute allowable deductions. The foregoing applies only to owners and investors, and not to dealers in securities, as to whom see article 1585. However, if stock of a cor-

poration becomes worthless, its cost or its fair market value as of March 1, 1913, if acquired prior thereto, may be deducted by the owner in the taxable year in which the stock was ascertained to be worthless and charged off, provided a satisfactory showing of its worthlessness be made as in the case of bad debts. See article 151.

ART. 145. Losses of farmers.—Losses incurred in the operation of farms as business enterprises are deductible from gross income. If farm products are held for favorable markets, no deduction on account of shrinkage in weight or physical value or by reason of deterioration in storage shall be allowed. The total loss by frost, storm, flood or fire of a prospective crop, or of a crop which has not been sold, 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. If live stock has been purchased for any purpose, and afterwards dies from disease, exposure or injury, or is killed by order of the authorities of a State or the United States, the actual purchase price of such stock, less any depreciation which may have been previously claimed with respect to such perished live stock, and less also any insurance or indemnity recovered, may be deducted as a loss. The actual cost of other property, less depreciation already allowed, 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. In determining the cost of stock for the purpose of ascertaining the deductible loss there shall be taken into account only the purchase price, and not the cost of any feed, pasturage or care which has been deducted as an expense of operation. If gross income is ascertained by inventories, no deduction can be made for live stock or products lost during the year, whether purchased for resale or produced on the farm, as such losses will be reflected in the inventory by reducing the amount of live stock or products on hand at the close of the year. If an individual owns and operates a farm, in addition to being engaged in another trade, business or calling, and sustains a loss from such operation of the farm, then the amount of loss sustained may be deducted from gross income received from all sources, provided the farm is not operated for recreation or pleasure. See articles 38, 110 and 171.

DEDUCTIONS ALLOWED: BAD DEBTS.

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

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

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

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

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

than the mortgagee may the difference between the debt and the net proceeds from the sale be deducted as a bad debt.

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, but not exceeding their amortized value if purchased at a premium. 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.

DEDUCTIONS ALLOWED: DEPRECIATION.

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

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

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

ART. 162. Depreciable property.—The necessity for a depreciation allowance arises from the fact that certain property used in the business gradually approaches a point where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art or to 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 improve-

ments or physical development added to it. It does not apply to bodies of minerals which through the process of removal suffer depletion, other provision for this being made in the statute. See articles 201-233. 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. There can be no such allowance in respect of good will, trade names, trademarks, trade brands, secret formulae or processes.

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

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

ART. 166. Modification of method of computing depreciation.—If it develops that the useful life of the property has been underestimated, the plan of computing depreciation should be modified and the balance of the cost of the property, or its fair market value as of March 1, 1913, not already provided for through a depreciation reserve or deducted from book value, should be spread over the estimated remaining life of the property. A taxpayer who in computing depreciation allowances in returns for years prior to 1918 has not taken ordinary obsolescence into consideration may for the year 1918 and subsequent years revise the estimate of the useful life of any property so as to allow for such future obsolescence as may be expected from experience to result from the normal progress of the art. No modification of the method should be made on account of changes in the market value of the property from time to time, such as, on the one hand, loss in rental value of 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 estimate of the useful life of the property.

ART. 167. Depreciation of patent or copyright.—In computing a depreciation allowance in the case of a patent or copyright, the capital sum to be replaced is the cost (not already deducted as current expense) of the patent or copyright or its fair market value as of March 1, 1913, if acquired prior thereto. The allowance should be computed by an apportionment of the cost of the patent or copyright or of its fair market value as of March 1, 1913, over the life of the patent or copyright since its grant, or since its acquisition by the taxpayer, or since March 1, 1913, as the case may be. If the patent or copyright was acquired from the Government, its cost consists of the various Government fees, cost of drawings, experimental models, attorney's fees, etc., actually paid. If a corporation purchased a patent and paid for it in stock or securities, its cost is the fair market value of the stock or securities at the time of the purchase. Depreciation of a patent can be taken on the basis of the fair market value as of March 1, 1913, only when affirmative and satisfactory evidence of such value is offered. Such evidence should whenever practicable be submitted with the return. If the patent becomes obsolete prior to its expiration such proportion of the

amount on which its depreciation may be based as the number of years of its remaining life bears to the whole number of years intervening between the date when it was acquired and the date when it legally expires may be deducted, if permission so to do is specifically secured from the Commissioner. Owing to the difficulty of allocating to a particular year the obsolescence of a patent, such permission will be granted only if affirmative and satisfactory evidence that the obsolescence occurred in the year for which the return is made is submitted to the Commissioner. The fact that depreciation has not been taken in prior years does not entitle the taxpayer to deduct in any taxable year a greater amount for depreciation than would otherwise be allowable. See articles 40 and 843.

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

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

ART. 170. Closing depreciation account.—If the use of any property in the business is permanently discontinued, although no sale or other disposition of the property has taken place, a determination

of any gain or loss may be made; but any deduction in respect of any loss thereon must be disclosed in the taxpayer's return for the year in which the determination is made and a full statement of the facts and the basis upon which the computation is calculated must be attached to the return. Upon a sale or other disposition of the property, the consideration received shall be compared with the amount of the estimated salvage value used in computing the gain or loss as above provided, and the amount of the difference shall be treated as a gain or loss, as the case may be, of the year in which the sale or other disposition was made. See articles 141-145.

ART. 171. Depreciation in the case of farmers.—A reasonable allowance for depreciation may be claimed on farm buildings (other than a dwelling occupied by the owner), farm machinery and other physical property, including live stock purchased for draft, dairy or breeding purposes, but no claim for depreciation on live stock raised, or purchased for resale, will be allowed. Live stock purchased for draft, breeding or dairy purposes, or for any purpose other than resale, may be included in the inventory for each year at a figure which will reflect the reduction in value estimated to have occurred during the year through increase of age or other causes. Such a reduction in value should be based on the cost and estimated life of the live stock. If an inventory is not used, a reasonable allowance for depreciation may be claimed based upon the cost of draft and work animals and animals kept solely for breeding purposes and not for resale. See also articles 38, 110 and 145.

DEDUCTIONS ALLOWED: AMORTIZATION.

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

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

* * *

ART. 181. Scope of provision for amortization.—Any allowance made to a taxpayer by a contracting Department of the Government or by any other contractor for amortization or fall in the value of property, either as a part of the cost of production or as a part of the price of the product, shall be included in gross income. See article 52. The amount to be allowed as a deduction from gross income for amortization for the purpose of the tax is to be based upon the provisions of articles 181 to 188, pursuant to which the deduction should be made instead of upon the basis of any amounts contractually or otherwise determined. The allowance for amortization covers the decline in value of the property subject thereto and is inclusive of the depreciation which would ordinarily be allowable separately. Depreciation for any taxable period after December 31, 1917, should, therefore, not be claimed with respect to property as to which an allowance for amortization is claimed. See also section 204 of the statute and articles 1601–1603.

ART. 182. Property cost of which may be amortized.—The taxpayer may make a reasonable deduction from gross income not in excess of a sum sufficient to extinguish the cost of buildings, machinery, equipment or other facilities constructed, erected, installed or acquired on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war, and of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of the present war. In the case of property the construction or installation of which was commenced before April 6, 1917, and completed subsequently to that date, amortization will be allowed with respect only to the cost incurred on or after April 6, 1917.

ART. 183. Cost recoverable through amortization.—The total amount to be extinguished by amortization, in general, is the excess of the unextinguished or unrecovered cost of the property over its maximum value (either for sale or for use as part of the plant or equipment of a going business) under stable postwar conditions. Under the provisions of the statute authorizing reexamination of the claim at any time within three years after the termination of the present war, the allowance will be finally determined upon such basis. However, in many cases it will be impracticable during the calendar year 1919 to make final determination either of the length of the amortization period or of the value of the property under stable postwar conditions. Consequently, in returns made during the calendar year 1919 the amortization allowance will tentatively be determined in accordance with articles 184 and 185.

ART. 184. Cost which may be amortized.—For the purpose of making returns in 1919 the total amount to be extinguished by amortization is the difference between the value of the property on the bases indi-

cated below and the original cost of the property less any amounts otherwise deducted for depreciation, losses, etc., prior to January 1, 1918; or in the case of property acquired or completed after December 31, 1917, it is the difference between the value of the property on the bases indicated below and the cost of such property at the date of acquisition or completion.

(1) In the case of property useful only during the war period and permanently discarded at the date of the return the basis is the salvage value as of the date when the property was discarded.

(2) In the case of property still in use which will not be required for the future use of the business and which is certain to be permanently discarded before the last installment payment of the tax covered by the return the basis is the salvage value as of the date when the property will be permanently discarded.

(3) In the case of other property the basis is the estimated reproduction cost as of April, 1919, of such property in its then condition. In the final determination such cost will be ascertained under stable postwar conditions, without reference to such date.

A special record of all property falling in classes (1) and (2) must be preserved by the taxpayer and the Commissioner must be promptly advised (*a*) if such property is restored to use; (*b*) the selling price if sold; and (*c*), if still on hand and not in use at the close of the three year period, the reasons why such property has not been disposed of.

ART. 185. Method of amortization.—For the purpose of making returns in 1919 the amount to be extinguished by amortization shall be spread in proportion to the net income (computed without benefit of the amortization allowance) between January 1, 1918, and the following dates: (*a*) if the claim is based on subdivision (1) of article 184, the date when the property was permanently discarded; (*b*) if the claim is based on subdivision (2) of article 184, the date upon which the property will be permanently discarded; and (*c*) if the claim is based upon subdivision (3) of article 184, April, 1919. All taxpayers claiming an allowance for amortization will be required to estimate the amount of their net income for the period between January 1, 1918, and the dates specified above, and also to estimate what part of such net income is properly allocable to the calendar year 1918 and what part thereof is properly allocable to the calendar year 1919. Such estimates shall be the basis for apportioning the amounts to be extinguished by amortization between the calendar years 1918 and 1919. Taxpayers reporting on the fiscal year basis (*a*) in all computations based upon 1918 rates shall use the amount of such allowance apportioned to the calendar year 1918; (*b*) in any computation based upon 1919 rates for a year beginning in 1918 and ending in 1919 shall use the amount of such allowance apportioned to the

calendar year 1919; and (c) in any computation for a fiscal year beginning in 1919 shall use as many twelfths of the allowance apportioned to the calendar year 1919 as there are months of such fiscal year falling in the calendar year 1919.

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

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

ART. 188. Information to be furnished by taxpayer.—To obtain the benefit of this provision of the statute the taxpayer must establish to the satisfaction of the Commissioner that the entire deduction claimed and the proportion claimed for any particular year are reasonable. The taxpayer shall also submit a supplementary statement setting forth the following information: (a) a description of the property in reasonable detail; (b) the date or dates on which the property was acquired, and from whom, or, if constructed, erected or installed by the taxpayer, the dates on which such construction, erection or installation was begun and completed; (c) evidence establishing the intention of the taxpayer on and after April 6, 1917, or on and after the date of acquisition or the date of beginning construction, erection or installation, to devote such property or vessels to the production of articles (or, in the case of vessels, the transportation of articles or men) contributing to the prosecution of the present war; (d) the cost of construction, erection, installation or acquisition; (e) the value of the property after termination of the amortization period; (f) a segregation of the property perma-

nently discarded, or of the property which will be permanently discarded before the last installment payment covered by the return; (g) all deductions from gross income otherwise taken or claimed with respect to such property; (h) the computation by which the total amount to be extinguished by amortization was determined; and (i) the computation by which the proportion of the amortization charge claimed as a deduction in the taxable year for which the return is being made was determined.

DEDUCTIONS ALLOWED: DEPLETION.

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

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

ART. 201. Depletion of mines, oil and gas wells.—A reasonable deduction from gross income for the depletion of natural deposits and for the depreciation of improvements is permitted, based (a) upon cost, if acquired after February 28, 1913, or (b) upon the fair market value as of March 1, 1913, if acquired prior thereto, or (c) upon the fair market value within 30 days after the date of discovery in the case of mines, oil and gas wells discovered by the taxpayer after February 28, 1913, where the fair market value is materially disproportionate to the cost. The essence of this provision is that the owner of such property, whether it be a leasehold or 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 the fair market value as of March 1, 1913, of the properties owned prior to that date, or an amount equal to the fair market value within 30 days after the date of discovery of mines, oil or 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; plus in any case the subsequent cost of plant and equipment (less salvage value) and underground and overground development, which is not chargeable to current operating expense, but not including land values for purposes other than the extraction of minerals. Operating owners, lessors and lessees are entitled to deduct an allowance for depletion, but a stockholder in a mining or oil or gas corporation is not. See further articles 839 and 844.

ART. 202. Capital recoverable through depletion allowance in the case of owner.—In the case of an operating owner in fee or a lessor the capital remaining in any year recoverable through depletion allowances is the sum of (a) the cost of the property, or its fair market value as of March 1, 1913, or its fair market value within 30 days after discovery, as the case may be, plus (b) the cost of subsequent improvements and development not charged to current operating expenses, but minus (c) deductions for depletion which has or should have been taken to date and (d) the portion of the capital account, if any, as to which depreciation has been and is being deducted instead of depletion. The value of the surface of the land should be taken into consideration. In no case, however, may a lessor include in his capital recoverable through such an allowance any part of development costs not borne by the lessor nor any part of the discovery value.

ART. 203. Capital recoverable through depletion allowance in the case of lessee.—In the case of a lessee the capital remaining in any year recoverable through depletion allowances is the sum of (a) the cost of the leasehold, or its fair market value as of March 1, 1913, or its fair market value within 30 days after discovery, as the case may be, plus (b) the cost of subsequent improvements and development not charged to current operating expenses, but minus (c) deductions for depletion which has or should have been taken to date and (d) the portion of the capital account, if any, as to which depreciation has been and is being deducted instead of depletion. Any annual or periodical rents or royalties supplementing the bonus or other amount paid for the lease may be charged to current operating expenses or, until the property reaches the operating stage, to capital account, and in the latter event will form part of the capital returnable through deductions for depletion.

ART. 204. Apportionment of deductions between lessor and lessee.—As the value of property comprehends the interests of both lessor and lessee, no computation, for the purpose of depletion allowances, of the value of these interests separately as of any date which combined exceeds the value of the property in fee simple will be permitted. The same principle applies to holders of fractional interests. If the aggregate deduction claimed is deemed excessive, the Commissioner

may request the owner or lessee to show that the valuation claimed does not exceed the fair market value of the property at a specified date determined in the manner explained in article 206. The lessor and lessee shall, with the approval of the Commissioner, equitably apportion the allowance in the light of the peculiar conditions in each case and on the basis of their respective interests therein. To the return of every taxpayer claiming an allowance for depletion in respect of (a) property in which he owns a fractional interest only or (b) a leasehold or (c) property subject to a lease, there shall be attached a statement setting forth the name and address and the precise nature of the holdings of each person interested in the property.

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 upon request of the Commissioner 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 different from 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 deposits.—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 in methods of mining or extraction. The value sought should be that established assuming a transfer between a willing seller and a willing buyer as of that particular date. No rule or method of determining the fair market value of mineral property is prescribed, but 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 purposes of the capital stock tax, valuation for local or State taxation, partnership accountings, records of litigation in which the value of the property was in question, the amount at which the property may have been inventoried in probate court, disinterested appraisals by approved methods, and other factors.

ART. 207. Revaluation of deposits not allowed.—The cost of the property or its fair market value at a specified date, as the case may be, plus subsequent charges to capital account not deductible as current expense, will be the basis for determining the depletion and depreciation deductions for each year during the continuance of the ownership under which the fair market value or cost was fixed, and during such ownership there can be no revaluation for the purpose of this deduction. This rule will not forbid the redistribution of the capital account over the estimated number of units remaining in the property in accordance with either of the next two articles.

ART. 208. Determination of quantity of ore in mine.—Every taxpayer claiming a deduction for depletion will be required to estimate with respect to each separate property the total units (tons, pounds, ounces or other units) of ores and minerals reasonably known or on good evidence believed to have existed in the ground on March 1, 1913, or on the date of acquisition of the property, or within 30 days after the date of discovery, as the case may be. In estimating the total units of ores and minerals for purposes of depletion the property must be considered in the condition in which it was on March 1, 1913, or the date of acquisition, or within 30 days after the date of discovery, but if subsequently during the ownership of the taxpayer making the return additional recoverable mineral deposits have been discovered or developed which were not taken into account in estimating the number of units for purposes of depletion, or if it shall be discovered by working, development or exploration that ground previously estimated to contain commercially recoverable mineral is barren or contains only commercially unworkable mineral, a new estimate of the recoverable units of ores or minerals (but not of the cost or fair market value at a specified date) shall be made and when made shall thereafter constitute a basis for depletion. In the selection of the unit of estimate the custom or practice applicable to the type of mineral deposit and the character of the operations thereon should be considered. The estimate of the recoverable units of ores or minerals for the purpose of depletion shall include (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 deposit, and may also include (b) "prospective" or "probable" ores and minerals (in the same 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 depletion only as extensions of known deposits into undeveloped ground.

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 allowance for depletion of mines and oil wells.—When the cost or value as of March 1, 1913, or within 30 days after the date of discovery of the property shall have been determined, and the number of mineral units in the property as of the date of acquisition or valuation shall have been estimated, the division of the former amount by the latter figure will give the unit value for purposes of depletion, and the depletion allowance for the taxable year may be computed by multiplying such unit value by the number of units of mineral extracted during the year. If, however, proper additions are made to the capital account represented by the original cost or value of the property, or unforeseen circumstances necessitate a revised estimate of the number of mineral units in the ground, a new unit value for purposes of depletion may be found by dividing the capital account at the end of the year, less deductions for depletion to the beginning of the taxable year which have or should have been taken, by the number of units in the ground at the beginning of the taxable year. This number, unless a revision of the original estimate has been necessary, will equal the number of units in the ground at the date of original acquisition or valuation less the number extracted prior to the taxable year. If, however, a recalculation is needed, the number of units at the beginning of the year will be the sum of the gross production of the year and the estimated mineral reserves in the property at the end of the year.

ART. 211. Computation of allowance for depletion of gas wells.—On account of the peculiar conditions surrounding the production of natural gas it will be necessary to compute the depletion allowances 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, may be used and 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 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 pressures of new wells less the sum of the pressures at the end of the tax year, equals the depletion allowance.

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

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

ART. 214. Computation of depletion allowance for combined holdings of oil and gas wells.—(1) The recoverable oil belonging to the taxpayer shall be estimated separately on the smallest unit on which data are available, such as individual wells or tracts, and these added together into a grand total to be applied to the total capital account returnable through depletion. The capital account shall include the cost or value, as the case may be, of all oil or gas leases or rights within the United States and its possessions, plus all incidental costs of development not charged as expense nor returnable through depreciation. The unit value of the total recoverable oil or gas is the quotient obtained by dividing the total capital account recoverable through depletion by the total estimated recoverable oil or gas. This unit multiplied by the total number of units of oil or gas produced by the taxpayer during the taxable year from all of the oil and gas properties will determine the amount which may be allowably deducted from the gross income of that year.

(2) In the case of the gas properties of a taxpayer the depletion allowance for each pool may be computed by using the combined capital account returnable through depletion of all the tracts of gas land owned by the taxpayer in the pool and the average decline in rock pressures of all the taxpayer's wells in such pool in the formula given in article 211. The total allowance for depletion of the gas properties of the taxpayer will be the sum of the amounts computed for each pool.

ART. 215. Depletion of mine based on advance royalties.—Where the owner has leased a mining property for a term of years with a requirement in the lease that the lessee shall mine 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 agreed royalty per unit of such mineral whenever the same shall thereafter be mined 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 mining 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 mining or removal in such year of any ore or mineral so paid for in advance and

for which deduction has been once made. If for any reason any such mining lease shall be terminated before the ore or mineral therein which has been paid for in advance has been mined and removed, and the lessor repossesses the leased property, an amount equal to the aggregate deductions for depletion allowed in respect of ore or mineral not mined and removed by the lessee, but still in the ground, will be deemed income to the lessor and will be returned as such for the year in which the property is repossessed.

ART. 216. Depletion and depreciation accounts on books.—Every taxpayer claiming and making a deduction for depletion and depreciation of mineral property shall keep accurate ledger accounts in which shall be charged the fair market value as of March 1, 1913, or within 30 days after the date of discovery, or the cost, as the case may be, (a) of the property, and (b) of the plant and equipment, together with such amounts expended for development of the property or additions to plant and equipment since that date as have not been deducted as expense in his returns. These accounts shall be credited with the amount of the depreciation and depletion deductions claimed and allowed each year, or the amount of the depreciation and depletion shall be credited to depletion and depreciation reserve accounts, to the end that when the sum of the credits for depletion and depreciation equals the value or cost of the property, plus the amount added thereto for development or additional plant and equipment, less salvage value of the physical property, no further deduction for depletion and depreciation with respect to the property will be allowed. If dividends are paid out of a depletion or depreciation reserve, the stockholders must be expressly notified that the dividend is a return of capital and not an ordinary dividend out of profits. See article 1549.

ART. 217. Statement to be attached to return where depletion of mine claimed.—To the return of the taxpayer claiming a deduction for depletion or depreciation or both there should be attached a statement setting out: (a) whether the owner is a fee owner or lessee or both; (b) a description of the property owned in fee, if any, and a description of the leasehold property, if any, including the date of acquisition and the date of expiration of the lease; (c) the fair market value as of March 1, 1913, or within 30 days of the date of discovery, or the cost, as the case may be, of the property owned in fee and the leasehold property, together with a statement of the precise method by which the value or the cost of freehold and leasehold property was determined; (d) the estimated number of units of mineral or ore at the date of acquisition or of valuation in the property owned in fee and in the leasehold property separately, together with an explanation of the method used in estimating in each case the number of units of mineral or ore for purposes of depletion;

(*e*) the amount of capital applicable to each unit; (*f*) the number of units removed and sold during the year for which the return was made; (*g*) the total amount deducted on account of depletion and on account of depreciation, stated separately, up to the taxable year during the ownership of the taxpayer; and (*h*) any other data which would be helpful in determining the reasonableness of the depletion and depreciation deductions claimed in the return.

ART. 218. Statement to be attached to return where depletion of oil or gas claimed.—To each return made by a person owning or operating oil or gas properties, there should be attached a statement showing for each property the following information, which may be given in the form of a table, if desired, by taxpayers owning more than one property: (*a*) the fair market value of the property (exclusive of machinery, equipment, etc., and the value of the surface rights) as of March 1, 1913, if acquired prior to that date; or the fair market value of the property within 30 days after the date of discovery; or the actual cost of the property, if acquired subsequently to February 28, 1913, and not covered by the foregoing clause; (*b*) how the fair market value was ascertained, if the property came under the first or second head under (*a*); (*c*) the estimated quantity of oil or gas in the property at the time that the value or cost was determined; (*d*) the name and address of the person making the estimate and the manner in which this estimate was made, including a summary of the calculations; (*e*) the amount of capital applicable to each unit (this being found by dividing the value or cost, as the case may be, by the estimated number of units of oil or gas in the property at the time the value or cost was determined); (*f*) the quantity of oil or gas produced during the year for which the return is made (in the case of new properties it is desirable that this information be furnished by months); (*g*) the number of acres of producing and proven oil or gas land; (*h*) the number of wells producing at the beginning and end of the taxable year; (*i*) the date of completion of wells finished during the taxable year; (*j*) the date of abandonment of all wells abandoned during the taxable year; (*k*) a property map showing the location of the property and of the producing and abandoned wells, dry holes, and proven oil and gas land; (*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); (*g*) (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 mine.—The discovery of a mine or a natural deposit of mineral, whether it be made by an owner of the land or by a lessee, shall be deemed to mean (*a*) the bona fide discovery of a commercially valuable deposit of ore or mineral of a value materially in excess of the cost of discovery in natural exposure or by drilling or other exploration conducted above or below ground, or (*b*) the development and proving of a mineral or ore deposit which has been abandoned or apparently worked out, or sold, leased or otherwise disposed of, by an owner or lessee prior to the development of a body of ore or mineral of sufficient size, quality and character to determine it, in connection with the physical and geological conditions of its occurrence, to be a mineable deposit of ore or mineral having a value materially in excess of the cost of the proving and development. In determining whether a discovery has been made the Commissioner will take into account the peculiar conditions of the case, and every taxpayer claiming the value of a mineral deposit on the date of discovery or within 30 days thereafter for purposes of depletion will be required to attach to his return a statement setting forth the conditions and circumstances of the discovery and the size, character and location of the deposit, together with the cost of discovery, its value and the precise method used in determining the value.

ART. 220. Discovery of oil and gas wells.—In order to take advantage of his discovery on or after March 1, 1913, of oil or gas wells, the taxpayer must show (*a*) that the tract for which such valuation is

claimed was not proven oil land as to the particular sand or zone discovery of which is claimed at the time the so-called discovery was made, proven oil land being that which has been shown by finished wells, supplemented by geologic data, to be such that other wells drilled thereon are practically certain to be commercial producers; (b) that the discovery was a bona fide discovery of a commercial well of oil or gas or both of these substances on the property in question, a commercial well being one whose production is such as to offer a reasonable expectation of at least returning the capital invested in such well through the sale of the oil or gas or both derived therefrom during its economic life; and (c) that the fair market value of the property was materially in excess of the cost.

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 three 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 drilling began, the date of completion and beginning of production, the formations penetrated, the oil, gas and water sands penetrated, the casing record, including the record of perforations, and any other information tending to show the condition of the well and the location of the sand or zone from which the oil or gas is produced on the date the discovery was claimed; (c) the logs of enough other wells drilled prior to the date of completion of the discovery in the vicinity of the discovery well to convince the Commissioner that the sand or zone discovery of which is claimed was not known prior to the so-called discovery; (d) a sworn record of production, clearly proving the commercial productivity of the discovery well; (e) a sworn copy of the records, showing the cost of the property; and (f) 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. Charges to capital and to expense in the case of mine.—In the case of mining operations all expenditures for plant, equipment, development, rent and royalty prior to production, and thereafter all major items of plant and equipment, shall be charged to capital account for purposes of depletion and depreciation. After a mine has been developed and equipped to its normal and regular output capacity, however, the cost of additional minor items of equipment and plant, including mules, motors, mine cars, trackage, cables, trol-

ley wire, fans, small tools, etc., necessary to maintain the normal output because of increased length of haul or depth of working consequent on the extraction of mineral, and the cost of replacements of these and similar minor items of worn-out and discarded plant and equipment, may be charged to current expense of operations, unless the taxpayer elects to write off such expenditures through charges for depreciation.

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

ART. 224. Depreciation of improvements in the case of mine.—It shall be optional with the taxpayer, subject to the approval of the Commissioner, (a) whether the cost or value of the mining property, including ores and minerals, plant and equipment, and charges and

additions to capital account not charged to expense and deducted as expense on the returns of the taxpayer, shall be recovered at a rate established by current exhaustion of mineral, or (b) whether the cost or value of the mineral and charges to capital account of expenditures other than for physical property shall be recovered by appropriate charges based on depletion and the cost or value of plant and equipment shall be recovered by reasonable 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. Nothing in these regulations shall be interpreted to mean that the value of a mining plant and equipment may be reduced by depreciation or depletion 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, or that any part of the value of land for purposes other than mining may be recoverable through depletion or depreciation.

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

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

depletion must be maintained after that date. In any case in which it is found that the deductions taken between March 1, 1913, and December 31, 1915, are not reasonable, amended returns may be required for these years. See article 839.

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

ART. 228. Capital recoverable through depletion allowance in the case of timber.—In general, the capital remaining in any year recoverable through depletion allowances may be determined as indicated in articles 202 and 203. In the case of leases the apportionment of deductions between the lessor and lessee should be made as specified in article 204. Where it becomes necessary to determine the cost or fair market value as of March 1, 1913, of the property, the rules laid down in articles 205 and 206 should be followed so far as possible.

ART. 229. Computation of allowance for depletion of timber.—An allowance for the depletion of timber in any taxable year shall be based upon the number of feet of stumpage cut during the year and the unit cost of the stumpage at the date of acquisition or the unit market value on March 1, 1913, if acquired prior thereto. The unit market value as of March 1, 1913, shall be the unit price at which the standing timber in its then condition and in view of its then environment could have been sold for cash or its equivalent. The amount of the deduction for depletion in any taxable year shall be the product of the number of feet of stumpage cut during the year multiplied by such unit cost or market value of the stumpage.

ART. 230. Revaluation of stumpage not allowed.—The fair market value of stumpage when determined as of March 1, 1913, for the purpose of depletion allowances in the case of timber acquired prior thereto, shall 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 stumpage was fixed, and during such ownership there can be no redetermination of the fair market value of the stumpage for such purpose. However, the unit market value of

stumpage adopted by the taxpayer may subsequently be changed if from any cause such value, if continued as a basis of depletion, should upon evidence satisfactory to the Commissioner be found inadequate or excessive for the extinguishment of the fair market value of the timber as of March 1, 1913.

ART. 231. Charges to capital and to expense in the case of timber.—In the case of timber operations all expenditures for plant, equipment, development, rent and royalty prior to production, and thereafter all major items of plant and equipment, shall be charged to capital account for purposes of depreciation. After a timber operation and plant has been developed and equipped to its normal and regular 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 expenses of operations.

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. Statement to be attached to return where depletion of timber claimed.—To the return of the taxpayer claiming a deduction for depletion or depreciation or both there should be attached a statement setting out (a) whether the owner is an owner in fee or a lessee or both; (b) a description of the property owned in fee, if any, and a description of the leasehold property, if any, including the date of acquisition and the date of expiration of the lease; (c) the cost

of the freehold and the leasehold property; (*d*) the number of feet of timber removed and sold during the year for which the return was made; (*e*) the total amount deducted on account of depletion and on account of depreciation, stated separately, up to the taxable year during the ownership of the taxpayer; and (*f*) any other data which would be helpful in determining the reasonableness of the depletion and depreciation deductions claimed in the return. The taxpayer shall keep accurate ledger accounts as outlined in article 216, and in general should comply with the requirements of the foregoing articles relating to the depletion of mines and oil and gas wells so far as applicable.¹

DEDUCTIONS ALLOWED: CHARITABLE CONTRIBUTIONS.

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

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

ART. 251. Charitable contributions.—Contributions or gifts within the taxable year are deductible to an aggregate amount not in excess of fifteen per cent of the taxpayer's net income including such payments, if made (*a*) to corporations or associations of the kind exempted from tax by subdivision (6) of section 231 of the statute or (*b*) to the special fund for vocational rehabilitation under the Vocational Rehabilitation Act of June 27, 1918. For a discussion of what corporations and associations are included within (*a*) see article 517. A gift to a common agency (as a war chest) for several such corporations or associations is treated like a gift directly to them. In connection with claims for this deduction there shall be stated on returns of income the name and address of each organization to which a gift was made, and the approximate date and the amount of the gift in each case. Where the gift is other than money, the basis for calculation of the amount of the gift shall be the fair market value of the property at the time given. A gift of real estate to a city to be maintained perpetually as a public park is not an allowable deduction. This article does not apply to gifts

¹ See T. D. 2916 of Sept. 5, 1919, for the addition of two new articles, 234 and 235.

by partnerships, estates and trusts, or corporations. See sections 218 and 219 of the statute and articles 561 and 562.

DEDUCTIONS ALLOWED: LOSS IN INVENTORY.

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

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

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

ART. 262. Loss from rebates.—Where after the close of the taxable year 1918 rebates have been bona fide paid in pursuance of contracts entered into during such year upon sales made during such year, the net income for that year may be reduced by the deduction of the

amount of such rebates actually paid. No such deduction will be allowed unless the profits from such sales have been included in the income for the taxable year 1918.

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

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

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

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

to the taxpayer. See section 252 of the statute and articles 1031-1038. In computing income for the taxable year 1919 the opening inventory must be properly adjusted by the taxpayer in respect of any claim allowed for the year 1918 under this article.

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

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

DEDUCTIONS ALLOWED: NONRESIDENT ALIEN INDIVIDUAL.

[SEC. 214.] (b) In the case of a nonresident alien individual the deductions allowed in paragraphs (1), (4), (7), (8), (9), (10), and (12), and clause (e) of paragraph (3), of subdivision (a) shall be allowed only if and to the extent that they are connected with income arising

from a source within the United States; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

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

ITEMS NOT DEDUCTIBLE.

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

- (a) Personal, living, or family expenses;
- (b) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;
- (c) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made; or
- (d) Premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy.

ART. 291. Personal and family expenses.—Insurance paid on a dwelling owned and occupied by a taxpayer is a personal expense. Premiums paid for life insurance by the insured are not deductible. In the case of a professional man who rents a property for residential purposes, but incidentally receives there clients, patients or callers in connection with his professional work (his place of business being elsewhere), no part of the rent is deductible as a business expense. If, however, he uses part of the house for his office, such portion of the rent as is properly attributable to such office is deductible. The father is legally entitled to the services of his minor children, and allowances which he gives them, whether said to be in consideration of services or otherwise, are not allowable deductions in his return of income. Alimony and an allowance paid under a separation agree-

ment are not deductible from gross income. See article 73. The cost of the equipment of an army officer to the extent only that it is specially required by his profession and does not merely take the place of articles required in civilian life is deductible. Accordingly, the cost of a sword is an allowable deduction, but the cost of a uniform is not.

ART. 292. *Traveling expenses.*—Traveling expenses, as ordinarily understood, include railroad fares and meals and lodging. If the trip is undertaken for other than business purposes, such railroad fares are personal expenses and such meals and lodging are living expenses. If the trip is on business, the railroad fares become business instead of personal expenses, but the meals and lodging continue to be living expenses and are not deductible in computing net income. (a) If, then, an individual whose business requires him to travel receives a salary as full compensation for his services, without reimbursement of traveling expenses, his expenses for railroad fares, but not for meals and lodging, are deductible from gross income. (b) If such an individual receives a salary and is also repaid his actual traveling expenses, no part of such expenses is deductible from gross income and no part of such repayment is returnable as income. (c) If such an individual receives a salary and also an allowance for meals and lodging, as, for example, a per diem allowance in lieu of subsistence, any excess of the cost of such meals and lodging over the allowance is not deductible, but any excess of the allowance over the actual expenses is taxable income. Congressmen and others who receive a mileage allowance for railroad fares should return as income any excess of such allowance over their actual expenses for such fares. A payment for the use of a sample room at a hotel for the display of goods is a business expense.

ART. 293. *Capital expenditures.*—Amounts paid for increasing the capital value or for restoring the depreciated value of property are not deductible from gross income. See section 214 (a) (8) of the statute and article 161. Amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architect's services is part of the cost of the building. Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities are an offset against the selling price. Expenses of the administration of an estate, such as court costs, attorney's fees and executor's commissions, are chargeable against the corpus of the estate and are not allowable deductions. Amounts to be assessed and paid under an

agreement between bondholders or stockholders of a corporation, to be used in a reorganization of the corporation, are investments of capital and not deductible for any purpose in returns of income. See article 543. An assessment paid by a stockholder of a national bank on account of his statutory liability is similarly not deductible. As to items not deductible by corporations, see section 235 and articles 581 and 582.

ART. 294. Premiums on business insurance.—Where the taxpayer pays premiums on an insurance policy on the life of an officer, employee or individual financially interested in the taxpayer's business, for the purpose of protecting himself from loss in the event of the death of any such person, such premiums are not deductible from his gross income. But if the taxpayer is in no sense a beneficiary under such a policy, except as he may derive advantage from the increased efficiency of the employee, and pays the premiums purely as reasonable additional compensation of such employee, they are allowable deductions. See articles 33 and 105-108. In either case whether the proceeds of such policies paid upon the death of the insured may be excluded from gross income or must be included therein depends upon whether the beneficiary is an individual or a corporation. See section 213 (b) (1) and articles 72 and 541.

CREDITS ALLOWED.

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

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

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

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

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

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

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

ART. 302. Personal exemption of head of family.—A head of a family is a person 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 the head of a family.

ART. 303. Personal exemption of married person.—In the case of a married man or married woman the joint exemption replaces the individual exemption only if the man lives with his wife or the woman lives with her husband. In the absence of continuous actual residence together, whether or not a man or woman has a wife or husband living with him or her within the meaning of the statute must depend on the character of the separation. If merely occasionally and temporarily a wife is away on a visit or a husband is away on business, the joint home being maintained, the additional exemp-

tion applies. The unavoidable absence of a wife or husband at a sanatorium or asylum on account of illness does not preclude claiming the exemption. If, however, the husband voluntarily and continuously makes his home at one place and the wife hers at another, they are not living together for the purpose of the statute, irrespective of their personal relations. A resident alien with a wife residing abroad is not entitled to the joint exemption.

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

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

ART. 306. Credits to nonresident alien individual.—A nonresident alien individual, similarly to a citizen or resident, is entitled for the purpose of the normal tax to credit dividends from domestic or

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

ARR. 307. When nonresident alien individual entitled to personal exemption.—(a) The following is an incomplete list of countries which either impose no income tax or in imposing an income tax allow both a personal exemption and a credit for dependents which satisfy the similar credit requirement of the statute: Argentina; Bosnia; Brazil; Canada; Carinthia; China; Cuba; Dalmatia; Denmark; France; Herzegovina; Istria; Mexico; Montenegro; Persia; Portugal; Roumania; Russia; Serbia; Union of South Africa. (b) The following is an incomplete list of countries which in imposing an income tax allow a personal exemption which satisfies the similar credit requirement of the statute, but do not allow a credit for dependents: Bachka; Banat of Temesvar; Croatia; Italy; Slavonia. (c) The following is an incomplete list of countries which in imposing an income tax do not allow to citizens of the United States not residing in such country either a personal exemption or a credit for dependents and, therefore, fail entirely to satisfy the similar credit requirement of the statute: Australia; Great Britain and Ireland; Japan; New Zealand; Spain. The former names of certain of these territories are here used for convenience, in spite of an actual or possible change in name or sovereignty. A nonresident alien individual who is a citizen or subject of any country in the first list is entitled for the purpose of the normal tax to such credit for a personal exemption and for dependents as his family status may warrant. If he is a citizen or subject of any country in the second list he is entitled to a credit for a personal exemption, but to none for dependents. If he is a citizen or subject of any country in the third list he is not entitled to credit for either a personal exemption or for dependents. If he is a citizen or subject of a country which is in none of the lists, then to secure credit for either a personal exemption or for dependents he must prove to the satisfaction of the Commissioner

that his country does not impose an income tax or that in imposing an income tax it grants the similar credit required by the statute.

NONRESIDENT ALIENS—ALLOWANCE OF DEDUCTIONS AND CREDITS.

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

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

ART. 312. Who is a nonresident alien individual.—“Nonresident alien individual” means an individual (a) whose residence is not within the United States and (b) who is not a citizen of the United States. Any alien living in the United States who is not a mere transient is a resident of the United States for purposes of the income tax. Whether he is a transient or not is determined by his intentions with regard to his stay. If he lives in the United States and has no definite intention as to his stay, he is a resident. The best evidence

of his intention is afforded by the conduct, acts and declarations of the alien. The typical transient is one who stops for a short time in the course of a journey through the United States, sometimes performing labor, sometimes not, or one who enters the United States intending only to stop long enough to carry out some purpose, object or plan not involving an extended stay. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient.

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

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

ART. 315. Duty of employer to determine status of alien employee.—Aliens employed in the United States are prima facie regarded as nonresidents. If wages are paid without withholding the tax, except as permitted in the following article, the employer should be provided with written proof of facts which overcome the presumption that such alien is a nonresident. Such facts include the following: (a) If an alien has been living in the United States for as much as one year immediately prior to the time he entered the employment of the withholding agent, or if he has been regularly employed by a

resident individual or corporation in the same county for as much as three months immediately prior to any payment by the employer, he may be treated as a resident in the absence of facts known to the employer showing that he is in fact a transient, such as one of the types mentioned under article 312. The facts with regard to the length of time the alien has thus lived in the country or county and has been so regularly employed may be established by the certificate of the alien. (b) The employer may also obtain evidence to overcome the prima facie presumption of nonresidence by securing from the alien form 1078 (revised) or an equivalent certificate of the alien establishing residence. Having secured such evidence from the alien, the employer may rely thereon unless the statement of the alien was false and the employer has reasonable cause to believe it false, and may continue to rely thereon until the alien ceases to be a resident under the provisions of article 314. An employer who seeks to account for failure to withhold in the past, if he did not at the time secure form 1078 (revised) or its equivalent, is permitted to prove the former status of the alien by any material evidence.

ART. 316. Allowance of personal exemption to nonresident alien employee.—A nonresident alien employee, provided he is entitled under section 216 of the statute and articles 301–307 to credit for a personal exemption or for dependents or both, may claim the benefit of such credit by filing with his employer form 1115, duly filled out and executed under oath. See particularly the lists of foreign countries in article 307. On the filing of such a claim the employer shall examine it. If on such examination it appears that the claim is in due form, that it contains no statement which to the knowledge of the employer is untrue, that such employee on the face of the claim is entitled to credit, and that such credit has not yet been exhausted, such employer need not until such credit be in fact exhausted withhold any tax from payments of salary or wages made to such employee. Every employer with whom affidavits of claim on form 1115 are filed by employees shall preserve such affidavits until the following calendar year, and shall then file them, attached to his annual withholding return on form 1042 (revised), with the collector on or before March 1. In case, however, when the following calendar year arrives such employer has no withholding to return, he shall forward all such affidavits of claim directly to the Commissioner (Sorting Division), 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 com-

pensation by an employer to an employee. See further section 221 and articles 361-376.

PARTNERSHIPS AND PERSONAL SERVICE CORPORATIONS.

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

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

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

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

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

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

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

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

ART. 323. Credits allowed partners.—In addition to the credits ordinarily allowed to an individual, a partner is entitled to the following credits: (a) a credit against net income for the purpose of the normal tax only of his proportionate share of such dividends from corporations subject to tax and of such interest not entirely exempt from tax upon obligations of the United States and bonds of the War Finance Corporation as are received by the partnership; and (b) a credit against income tax of the partner's proportionate share of any income, war profits and excess profits taxes of the partnership paid or accrued during the taxable year to a foreign country upon income derived from sources therein, or to any possession of the United States, subject to the limitations of section 222 of the statute. See section 216 and articles 301 and 381–384.

ART. 324. Taxation of partners in partnership with fiscal year ending in 1918.—If the fiscal year of a partnership began in the calendar year 1917 and ended in the calendar year 1918, the rates of tax for the calendar year 1917 apply to the amount of each partner's distributive share of the net income of the partnership for such fiscal

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

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

ART. 326. Taxation of partners in partnership with fiscal year ending in 1919.—If the fiscal year of a partnership began in the calendar year 1918 and ends in the calendar year 1919, the rates of tax for the

calendar year 1918 apply to the amount of each partner's distributive share of the net income of the partnership for such fiscal year attributable to the calendar year 1918, and the rates for the calendar year 1919 to the amount of each partner's distributive share of such net income of the partnership attributable to the calendar year 1919.

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

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

ART. 328. Personal service corporations.—Personal service corporations are defined in section 200 of the statute. See articles 1523-1532. Such corporations are not subject to tax as corporations, unless they make returns for fiscal years beginning in 1917, but they are required to make returns of income. See sections 231, 239 and 304 of the statute and the articles thereunder. An individual stockholder of a personal service corporation is, however, subject to tax much like a member of a partnership upon his distributive share of the net income of the corporation. The net income of a personal service corporation, as in the case of a partnership, shall be computed in the same manner

and on the same basis as the net income of an individual, except that the deduction of contributions or gifts is not permitted. See section 212 and articles 21-26. A corporation which is taxable under section 303 is not a personal service corporation and its stockholders are taxed like stockholders in an ordinary corporation.

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

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

ART. 331. Credits allowed stockholders of personal service corporation.—A stockholder of a personal service corporation is entitled to credit for the purpose of the normal tax only for amounts received in distribution of earnings or profits of the corporation accumulated since February 28, 1913, and prior to January 1, 1918. See sections 201 and 216 of the statute and articles 1541 and 301. In addition to the credits ordinarily allowed to an individual a stockholder of a personal service corporation is entitled to the following

credits: (a) a credit against net income for the purpose of the normal tax only of his proportionate share of such dividends from a corporation subject to tax and of such interest not entirely exempt from tax upon obligations of the United States and bonds of the War Finance Corporation as are received by the personal service corporation, and (b) a credit against income tax of the stockholder's proportionate share of income, war profits and excess profits taxes of the personal service corporation paid or accrued during the taxable year to a foreign country upon income derived from sources therein, or to any possession of the United States, subject to the limitations of section 222 of the statute. See articles 381-384.

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

ART. 333. Application of different tax rates in the case of fiscal year of personal service corporation ending in 1918.—Any deductions, exemptions or credits to which the stockholder of a personal service corporation with a fiscal year ending in 1918 is entitled shall first be applied against his income subject to the rates for the calendar year

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

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

ART. 335. Application of different tax rates in the case of fiscal year of personal service corporation ending in 1919.—Any deductions, exemp-

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

ESTATES AND TRUSTS.

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

- (1) Income received by estates of deceased persons during the period of administration or settlement of the estate;
- (2) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests;
- (3) Income held for future distribution under the terms of the will or trust; and
- (4) Income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals, and the income collected by a guardian of an infant to be held or distributed as the court may direct.

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

(c) In cases under paragraph (1), (2), or (3) of subdivision (a) the tax shall be imposed upon the net income of the estate or trust and shall be paid by the fiduciary, except that in determining the net income of the estate of any deceased person during the period of administration or settlement there may be deducted the amount of any income properly paid or credited to any legatee, heir or other bene-

fiary. In such cases the estate or trust shall, for the purpose of the normal tax, be allowed the same credits as are allowed to single persons under section 216.

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

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

ARR. 342. Estates and trusts taxed to fiduciary.—In the case of (a) estates of decedents before final settlement and of (b) trusts, whether created by will or deed, for accumulation of income, whether for unascertained persons or persons with contingent interests or otherwise, the income is taxed to the fiduciary as to any single individual, except that from the income of a decedent's estate there may first be deducted any amount of income properly paid or credited to a beneficiary. See section 200 of the statute and articles 1521 and 1522. Where under the terms of the will or deed the trustee may in his discretion distribute the income or accumulate it, the income is taxed to the trustee, irrespective of the exercise of his discretion. The

imposition of the tax is not affected by the fact that an ultimate beneficiary may be a person exempt from tax. A statutory allowance paid a widow out of the corpus of the estate is not deductible from gross income. As an intestate's real estate does not pass to his administrator, upon a sale by the heirs, whether before or after settlement of the estate, each heir is taxed individually on any profit derived.

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

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

ART. 345. Estates and trusts taxed to beneficiaries.—In the case of (a) a trust the income of which is distributable periodically, (b) an ordinary guardianship of a minor, and (c) an estate of a decedent before final settlement as to any income properly paid or credited as such to a beneficiary, the income is taxable directly to the beneficiary or beneficiaries. Each beneficiary must include in his return his distributive share of the net income, even though not yet paid him, but if the taxable year on the basis of which he makes his returns fails to coin-

cide with the annual accounting period of the estate or trust, then he need only include in his return his distributive share for such accounting period ending within his taxable year. The regulations governing partnerships are generally applicable to such an estate or trust. See articles 321-327.

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

PROFITS OF CORPORATIONS TAXABLE TO STOCKHOLDERS.

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

ART. 351. Profits of corporation taxable to stockholders.—Where a domestic or foreign corporation permits its gains and profits to accumulate for the purpose of preventing the imposition of the surtax upon such income if distributed to its stockholders, it shall not

be subject to the income tax as a corporation, but its stockholders shall be subject to tax in the same way as the stockholders of a personal service corporation, except that the war profits and excess profits tax on the corporation shall first be deducted from its net income before computing the proportionate shares of the stockholders. See section 218 of the statute and articles 328-335. In any case the Commissioner or a collector may require a corporation to furnish a statement of its gains and profits and of the names, addresses and shareholdings of the stockholders. If upon the basis of such statement or other evidence the Commissioner certifies that in his opinion its accumulation of profits is unreasonable for the purposes of the business, but only if he so certifies, the corporation and its stockholders shall make their returns accordingly.

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

ART. 353. Unreasonable accumulation of profits.—An accumulation of gains and profits is unreasonable if it is not required for the purposes of the business, considering all the circumstances of the case. No attempt can be made to enumerate all the ways in which gains and profits of a corporation may be accumulated for the reasonable needs of the business. Undistributed income is properly accumulated if invested in increased inventories or additions to plant

reasonably needed by the business. It is properly accumulated if retained for working capital required by the business or in accordance with contract obligations placed to the credit of a sinking fund for the purpose of retiring bonds issued by the corporation. In the case of a banking institution the business of which is to receive and loan money, using capital, surplus and deposits for that purpose, undistributed income actually represented by loans or reasonably retained for future loans is not accumulated beyond the reasonable needs of the business. The nature of the investment of gains and profits is immaterial if they are not in fact needed in the business.

PAYMENT OF TAX AT SOURCE.

SEC. 221. (a) That all individuals, corporations and partnerships, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the United States, having the control, receipt, custody, disposal, or payment, of interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income, of any nonresident alien individual (other than income received as dividends from a corporation which is taxable under this title upon its net income) shall (except in the cases provided for in subdivision (b) and except as otherwise provided in regulations prescribed by the Commissioner under section 217) deduct and withhold from such annual or periodical gains, profits, and income a tax equal to 8 per centum thereof: *Provided*, That the Commissioner may authorize such tax to be deducted and withheld from the interest upon any securities the owners of which are not known to the withholding agent.

(b) In any case where bonds, mortgages, or deeds of trust, or other similar obligations of a corporation contain a contract or provision by which the obligor agrees to pay any portion of the tax imposed by this title upon the obligee, or to reimburse the obligee for any portion of the tax, or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon or to retain therefrom under any law of the United States, the obligor shall deduct and 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 section 217.

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

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

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

ART. 361. Withholding tax at source.—In general withholding is required (a) of a tax of 8 per cent in the case of fixed or determinable annual or periodical income (other than dividends from corporations liable to the income tax and interest upon corporate bonds containing a tax-free covenant clause) payable to a nonresident alien individual; (b) of a tax of 10 per cent in the case of fixed or determinable annual or periodical income (other than dividends from corporations liable to the income tax and interest upon corporate bonds containing a tax-free covenant clause) payable to a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein; and (c) of a tax of 2 per cent in the case of interest payable to an individual or a partnership, whether resident or nonresident, or to a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein, upon bonds or other obligations of domestic or resident foreign corporations containing a so-called tax-free covenant clause. Withholding in all cases at the highest applicable rate is also required from interest on bonds or other securities where the owner of such securities is unknown to the withholding agent. 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 agency in this country is required to withhold a tax of 2 per cent upon the interest on its tax-free covenant bonds. See further sections 200, 217, 237 and 256 of the statute and articles 1533, 311-316, 601 and 1071-1080.

ART. 362. Fixed or determinable annual or periodical income.—Only (a) fixed or determinable (b) annual or periodical income is sub-

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

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

ART. 364. Ownership certificates for interest coupons.—The owners of bonds or other obligations, whether or not containing a tax-free covenant, issued by domestic or resident foreign corporations, when presenting interest coupons for payment shall file a certificate of ownership for each issue of bonds, showing the name and address of the debtor corporation, the name and address of the owner of the bonds, whether the payee is married or the head of a family, 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 included in gross income, nor in the case of any obligations of the United States. See section 213 (b) of the statute and articles 74–82. Where in connection with the sale of its prop-

erty 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.

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

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

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

given the original certificates of ownership. The use of substitute certificates by collecting agents, banks and bankers is not permitted, however, in the case of ownership certificates presented with coupons for collection by nonresident alien individuals, partnerships or corporations.

ART. 368. Interest coupons without ownership certificates.—Where interest coupons are received unaccompanied by certificates of ownership the first bank shall require of the payee an affidavit showing the name and address of the payee, the name and address of the debtor corporation, the date of the maturity of the interest, the name and address of the person from whom the coupons were received, the amount of the interest, and a statement that the owner of the bonds is unknown to the payee. Such affidavit shall be forwarded to the collector with the monthly return on form 1012 (revised). The first bank receiving such coupons shall also prepare a certificate on form 1000 (revised), crossing out "owner" and inserting "payee" and entering the amount of interest in the space provided for a foreign corporation having no office or place of business within the United States, and shall stamp or write across the face of the certificate "Affidavit furnished," adding the name of the bank.

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

ART. 370. Return of tax withheld.—(a) Every withholding agent shall make an annual return to the collector of the tax withheld from interest on corporate bonds or other obligations on or before March 1 on form 1013 (revised). He shall also make a monthly return on form 1012 (revised) on or before the 20th day of the month following that for which the return is made. The original ownership certificates, or the substitute certificates where authorized, must be forwarded to the collector with the monthly return. (b) Every person required to deduct and withhold any tax from income other than such bond interest shall make an annual return thereof to the collector on or before March 1 on form 1042 (revised), accompanied by a separate report on form 1098 (revised) for each nonresident

alien individual or foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein, to whom income other than bond interest was paid during the previous taxable year. In every case of both classes the tax withheld must be paid on or before June 15 of each year to the collector. For penalties attaching upon failure to make such returns or such payment, see section 253 of the statute and article 1041.

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

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

ART. 373. Use of information return where no actual withholding.—Where a debtor corporation or its duly authorized withholding agent

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

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

ART. 375. Withholding in the case of enemies.—Payments made after October 6, 1917, to the alien property custodian are in the same category as payments made to or for citizens or residents of the United States. Withholding at the source is accordingly unnecessary except in the case of interest payments on corporate bonds or other obligations containing a tax-free covenant where no exemption is claimed. The alien property custodian should use form 1000 (revised) in collecting interest on bonds containing a tax-free covenant and in all other cases should use form 1001 (revised). No distinction is to be made between payments directly to the alien property custodian and to his depositaries and between interest on registered bonds and interest on coupon bonds. In the case of enemies or allies of enemies holding a license granted under the provisions of the Trading with the Enemy Act, withholding is required as in the case of any nonresident alien not an enemy or ally of enemy. See article 446.

ART. 376. Return of income from which tax withheld.—The entire amount of the income from which the tax was withheld shall be included in gross income without deduction for such payment of the tax. But any tax actually so withheld shall be credited against the total tax as computed in the taxpayer's return. 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 where no fraud or purpose to evade payment is involved.

CREDIT FOR TAXES.

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

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

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

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

(4) In the case of any such individual who is a member of a partnership or a beneficiary of an estate or trust, his proportionate share of such taxes of the partnership or the estate or trust paid during the taxable year to a foreign country or to any possession of the United States, as the case may be.

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

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

ART. 381. Analysis of credit for taxes.—(1) In the case of a citizen of the United States, whether resident 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 possession of the United States”; (b) “the amount of any” such taxes paid or accrued “during the taxable year to any foreign country, upon income derived from sources therein”; and (c) the “proportionate share of” any “such taxes of” a partnership of which he is a partner or of an estate or trust of

which he is a beneficiary paid or accrued "during the taxable year to a foreign country or to any possession of the United States, as the case may be."

(2) In the case of an alien resident of the United States the basis of the credit for taxes is as follows: (a) "the amount of any income, war-profits and excess-profits taxes paid" or accrued "during the taxable year * * * to any possession of the United States" (identical with (1) (a) above); (b) "the amount of any such taxes paid" or accrued "during the taxable year to" the country of which he is a citizen or subject, "upon income derived from sources therein, if such country, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country"; and (c) the "proportionate share of" any "such taxes of" a partnership of which he is a partner or of an estate or trust of which he is a beneficiary paid or accrued "during the taxable year to" the country of which he is a citizen or subject ("if such country, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country"), "or to any possession of the United States, as the case may be." As to credits for taxes in the case of corporations see section 238 of the statute and article 611.

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

ART. 383. Conditions of allowance of credit.—(a) When credit is sought for income, war profits or excess profits taxes paid other than to the United States, the income tax return of the individual must be accompanied by form 1116, carefully filled out with all the information there called for and with the calculations of credits there indicated, and duly signed and sworn to or affirmed. When credit is sought for taxes already paid the form must have attached to it the receipt for each such tax payment. When credit is sought for taxes accrued the form must have attached to it the return on which each such accrued tax was based. This receipt or return so attached must be either the original, a duplicate original, a duly certified or authenticated copy, or a sworn copy. In case only a sworn copy of a receipt or return is attached, there must be kept readily available for comparison on request the original, a duplicate original or a duly certified or au-

thenticated copy. (b) In the case of a credit sought for a tax accrued but not paid, the Commissioner may require as a condition precedent to the allowance of credit a bond from the taxpayer in addition to form 1116. If such a bond is required, form 1117 shall be used for it. It shall be in such penal sum as the Commissioner may prescribe, and shall be conditioned for the payment by the taxpayer of any amount of tax found due upon any redetermination of the tax made necessary by such credit proving incorrect, with such further conditions as the Commissioner may require. This bond shall be executed by the taxpayer, his agent or representative, as principal, and by sureties satisfactory to and approved by the Commissioner. See also section 1320 of the statute.

ARR. 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.

INDIVIDUAL RETURNS.

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

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

ARR. 401. Individual returns.—Every individual whose net income, as defined in section 212 of the statute and articles 21–26, is \$1,000 or over for the taxable year must make a return of income unless married and living with husband or wife as defined in article 303. The return shall be for his taxable year, whether calendar or fiscal.

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

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

ART. 403. Return of income of minor.—An individual under 21 years of age or under the statutory age of majority where he lives, whatever it may be, is required to render a return of income if he has a net income of his own of \$1,000 or over for the taxable year. If he is married see article 401. If 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 any earnings for his own use, is at least \$1,000, a return as in the case of any other individual must be made by him or by his guardian or some other person charged with the care of his person or property for him. See article 422. If, however, a minor is dependent upon his parent, who appropriates or may appropriate his earnings, such earnings

are income of the parent and not of the minor for the purpose of the normal tax and surtax. In the absence of proof to the contrary a parent will be assumed not to have emancipated his minor child and must include in his return any earnings of the minor.

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

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

ART. 406. Verification of returns.—All income tax returns must be verified under oath or affirmation. Persons in the naval or military service of the United States may verify their returns before any official authorized to administer oaths for the purposes of those services. Income tax returns executed abroad may be attested free of

charge before United States consular officers. Where a foreign notary or other official having no seal shall act as attesting officer, the authority of such attesting officer should be certified to by some judicial official or other proper officer having knowledge of the appointment and official character of the attesting officer.

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

PARTNERSHIP RETURNS.

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

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

ART. 412. Contents of partnership return.—The return of a partnership shall state specifically (a) the items of its gross income enumerated in section 213 of the statute; (b) the deductions enumerated in section 214, other than the deduction provided in paragraph (11) of subdivision (a) of that section; (c) the amounts specified

in subdivisions (a) and (b) of section 216 received by the partnership; (d) the amount of any income, war profits and excess profits taxes of the partnership paid during the taxable year to a foreign country or to any possession of the United States, and the amount of any such taxes accrued but not paid during the taxable year; (e) the names and addresses of the individuals who would be entitled to share in the net income of the partnership if distributed; (f) the amount of the distributive share of such net income of each such individual; and (g) such other facts as are required by form 1065 (revised). See also sections 222 and 227 and articles 381-384 and 441-448.

FIDUCIARY RETURNS.

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

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

ART. 421. Fiduciary returns.—Every fiduciary, or at least one of joint fiduciaries, must make a return of income (a) for the individual whose income is in his charge, if the net income of such individual is \$2,000 or over if married and living with husband or wife or is \$1,000 or over in other cases, or (b) for the estate or trust for which he acts, if the net income of such estate or trust is \$1,000 or over or if any beneficiary of such estate or trust is a nonresident alien. The return in case (a) and also in case (b) if the tax is payable by the fiduciary shall be on form 1040 (revised), except that it may be on short form 1040 A (revised) where the net income does not exceed \$5,000. The return shall be on form 1041 (revised) in case (b) if the tax is payable by the beneficiaries. In such a case the fiduciary shall include in the return a statement of each beneficiary's distributive share of the net income, whether or not distributed before the close of the taxable year for which the return is made. See section 219 of the statute and articles 341-346. If the net income of a decedent from the beginning

of the taxable year to the date of his death was \$1,000, if unmarried, or \$2,000, if married, the executor or administrator shall make a return for such decedent. See article 305.

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

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

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

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

RETURNS WHEN ACCOUNTING PERIOD CHANGED.

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

In all of the above cases the net income shall be computed on the basis of such period for which separate return is made, and the tax shall be paid thereon at the rate for the calendar year in which such period is included; and the credits provided in subdivisions (c) and (d) of section 216 shall be reduced respectively to amounts which bear the same ratio to the full credits provided in such subdivisions as the number of months in such period bears to twelve months.

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

TIME AND PLACE FOR FILING RETURN.

SEC. 227. (a) That returns shall be made on or before the fifteenth day of the third month following the close of the fiscal year, or, if the return is made on the basis of the calendar year, then the return shall

be made on or before the fifteenth day of March. The Commissioner may grant a reasonable extension of time for filing returns whenever in his judgment good cause exists and shall keep a record of every such extension and the reason therefor. Except in the case of taxpayers who are abroad, no such extension shall be for more than six months.

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

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

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

Art. 443. Extension of time by collector.—It is important that the taxpayer render before the return due date a return as complete and final as it is possible for him to prepare. However, in cases of sickness or absence collectors are authorized to grant an extension of not exceeding thirty days, where in their judgment such further time is actually required for the making of an accurate return. See article 1002. The application for such extension must be made prior

to the expiration of the period for which the extension is desired. The absence or sickness of one or more officers of a corporation at the time the return is required to be filed will not be accepted as a reasonable cause for failure to file the return within the prescribed time, unless it is satisfactorily shown that there were no other principal officers available and sufficiently informed as to the affairs of the corporation to make and verify the return. As a condition of granting an extension of time for filing a return the collector may require the submission of a tentative return and estimate of the tax on form 1040 T in the case of individuals, or on form 1031 T in the case of corporations, and the payment of one-fourth of the estimated amount of tax.

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

ART. 445. Extension of time in the case of persons abroad.—In view of the disturbed conditions abroad and the consequent interference with the usual channels of communication, an extension of time for filing returns of income for 1918 and subsequent years and for paying the tax is hereby granted in the case of nonresident alien individuals and nonresident foreign corporations, or their proper representatives in the United States, and of American citizens residing or traveling abroad, including persons in military or naval service on duty outside the United States, for such period as may be necessary, not exceeding ninety days after proclamation by the President of the end of the war with Germany. The whole tax shown to be due must be paid at the time of filing the return. In all such cases an affidavit must be attached to the return, stating the causes of the delay in filing it, in order that the Commissioner may determine whether the failure to file the return in time was due to a reasonable cause and not to willful neglect. If the showing justifies the conclusion that the failure to file the return in time was excusable, no penalty will be imposed.

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

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

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

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

UNDERSTATEMENT IN RETURNS.

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

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

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

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

PART II A.
INCOME TAX ON CORPORATIONS.
TAX ON CORPORATIONS.

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

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

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

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

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

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

ART. 503. Corporations liable to tax.—Every corporation, domestic or foreign, not exempt under section 231 of the statute, is liable to the tax. It makes no difference that a domestic corporation may

receive no income from sources within the United States. On the other hand, a foreign corporation is taxed only on its income from sources within the United States. See section 233 of the statute and article 550. For what the term "corporation" includes and for the difference between domestic and foreign corporations see section 1 and articles 1501-1509.

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

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

CONDITIONAL AND OTHER EXEMPTIONS.

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

- (1) Labor, agricultural, or horticultural organizations;
- (2) Mutual savings banks not having a capital stock represented by shares;
- (3) Fraternal beneficiary societies, orders, or associations, (a) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and (b) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents;
- (4) Domestic building and loan associations and cooperative banks without capital stock organized and operated for mutual purposes and without profit;
- (5) Cemetery companies owned and operated exclusively for the benefit of their members;
- (6) Corporations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual;
- (7) Business leagues, chambers of commerce, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private stockholder or individual;

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

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

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

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

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

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

(14) Personal service corporations.

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

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

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

ART. 514. Fraternal beneficiary societies.—A fraternal beneficiary society is exempt from tax only if operated under the "lodge system," or for the exclusive benefit of the members of a society so operating. "Operating under the lodge system" means carrying on its activities under a form of organization that comprises local branches, chartered by a parent organization and largely self-governing, called lodges, chapters, or the like. In order to be exempt it is also necessary that the society have an established system for the payment to its members or their dependents of life, sick, accident or other benefits.

ART. 515. Building and loan associations.—A building and loan association entitled to exemption is one organized pursuant to the laws of the United States or of some State or Territory thereof, which accumulates funds to be loaned to its members and to be repaid in small periodical installments. The statute requires that the members of the association shall share in its profits on substantially the same footing. Subject to this requirement, it does not

prevent exemption that the association issues prepaid stock entitled to a specified percentage of the profits. Where, however, the association issues paid-up stock, the holders of which are entitled to a fixed dividend and also to share in the profits with all the other holders of stock, it is not exempt.

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

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

(1) Charitable corporations include an association for the relief of the families of clergymen, even though the latter make a contribution to the fund established for this purpose; or for furnishing the services of trained nurses to persons unable to pay for them; or for aiding the general body of litigants by improving the efficient administration of justice. Educational corporations may include an association whose sole purpose is the instruction of the public. This is true of an association to promote acquaintance with the Spanish language and literature, although it has incidental amusement features; of an association to increase knowledge of the civilization of another country; and of a Chautauqua association whose primary purpose is to give lectures on subjects useful to the individual and beneficial to the community and whose amusement features are incidental to this purpose. But associations formed to disseminate controversial or partisan propaganda are not educational within the meaning of the statute. Societies designed to encourage the performance of first class orchestral music are not exempt, the purpose being merely to provide a high grade of entertainment. 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. An association engaged in furnishing information to prospective investors, to enable them to make sound investments, is not such a league, since its members have no common business interest, and it is not exempt, even though all of its income is devoted to the purpose stated. A clearing house association, not organized for profit, no part of the net income of which inures to any private stockholder or individual, is exempt provided its activities are limited to the exchange of checks and similar work for the common benefit of its members. An association of persons who are engaged in the business of carrying freight and passengers by boats propelled by steam, which is designed to promote the legitimate objects of such business, and all of the income of which is derived from membership dues and is expended for office expenses and the salary of a secretary-treasurer, is exempt from tax. An incorporated cotton exchange, whose shares carry the right to dividends, is organized for profit and is not exempt.

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

ART. 520. Social clubs.—The exemption applies to practically all social and recreation clubs which are supported by membership fees,

dues and assessments. If a club, by reason of the comprehensive powers granted in its charter, engages in traffic, in agriculture or horticulture, or in the sale of real estate, timber, etc., for profit, such club is not organized and operated exclusively for pleasure, recreation or social purposes, and any profit realized from such activities is subject to tax.

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

ART. 522. Cooperative associations.—(a) Cooperative associations, acting as sales agents for farmers or others, in order to come within the exemption must establish that for their own account they have no net income. Cooperative dairy companies, which are engaged in collecting milk and disposing of it or the products thereof and distributing the proceeds, less necessary operating expenses, among their members upon the basis of the quantity of milk or of butter fat in the milk furnished by such members, are exempt from the tax. If the proceeds of the business are distributed in any other way than on such a proportionate basis, the company will be

subject to tax. A farmers' association is not exempt from taxation where in accounting to farmers furnishing produce for the proceeds of sales it deducts more than the necessary selling expenses incurred. (b) Cooperative associations acting as purchasing agents are not expressly exempt from tax and must make returns of income, but rebates made to purchasers, whether or not members of the association, in proportion to their purchases may be excluded from gross income in computing the net income subject to tax. Any profits made from non-members and distributed to members in the guise of rebates are, of course, subject to tax.

NET INCOME DEFINED.

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

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

GROSS INCOME DEFINED.

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

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

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

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

ART. 541. Gross income.—The gross income of a corporation for the purpose of the tax in general includes and excludes the same things as the gross income of an individual. It embraces not only the operating revenues, but also gains, profits and income from all

other sources, such as rentals, royalties, interest, dividends from stock in other corporations, and profits from the sale of capital assets. The proceeds of life insurance policies paid upon the death of the insured to a corporation beneficiary, less any premiums paid by the corporation and not deducted from gross income, are to be included in its gross income. See sections 213 and 215 of the statute and articles 31-88 and 294. But in the case of life and mutual marine insurance companies and of foreign corporations there are special provisions. See articles 548-550.

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

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

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

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

(3) (a) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible as interest 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.

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

corporation, the rules contained in section 202 of the statute and in articles 1561-1570 are particularly applicable.

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

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

ART. 548. Gross income of insurance companies.—The gross income of insurance companies consists of their total revenue from the operation of the business and of their income from all other sources within the taxable year, except as otherwise provided by the statute. Gross income includes net premiums (that is, gross premiums less returned premiums on policies cancelled and premiums on policies not taken), investment income, profits from the sale of assets, and all gains, profits and income reported to the State insurance departments, except income specifically exempt from tax. Premiums received by mutual marine insurance companies which are paid out for reinsurance should be eliminated from gross income and the payments for reinsurance from disbursements. Deposit premiums on perpetual risks received and returned by fire insurance companies should be treated in the same manner, as no reserve will be recog-

nized covering liability for such deposits. The earnings on such deposits must be included in the investment income. A net decrease in reserve funds required by law within the taxable year must be included in the gross income. See articles 568-572.

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

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

• DEDUCTIONS ALLOWED.

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

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

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

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

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

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

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

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

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

(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided*, That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further*, That in the case of mines,

oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee;

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

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

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

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

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

taxpayer has sustained a substantial loss of the character above described then the amount of such loss shall be deducted from the net income for the taxable year 1918 and the taxes imposed by this title and by Title III for such year shall be redetermined accordingly. Any amount found to be due to the taxpayer upon the basis of such redetermination shall be credited or refunded to the taxpayer in accordance with the provisions of section 252.

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

ART. 561. Allowable deductions.—In general the deductions from gross income allowed corporations are the same as allowed individuals, except that corporations may deduct dividends received from other corporations subject to the tax and may not deduct charitable contributions, and that insurance companies are permitted special deductions. See section 214 of the statute. Particularly, as to business expenses see articles 101–111; as to interest paid see articles 121 and 122; as to taxes paid see articles 131–134; as to losses see articles 141–145; as to bad debts see articles 151–154; as to depreciation see articles 161–171; as to amortization see articles 181–188; as to depletion see articles 201–233; and as to loss in inventory see articles 261–268.

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

ART. 563. Sale of capital stock, bonds and capital assets.—A corporation sustains no deductible loss from the sale of its capital stock. See article 542. If it sells its bonds at a discount, the amount of such discount is treated as interest paid, and if it retires its bonds at

a price in excess of the issuing price, such excess may usually be deducted as expense. See articles 544 and 848. If the corporation sells its capital assets for less than their cost or fair market value as of March 1, 1913, the loss sustained is deductible. See article 545.

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

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

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

ART. 567. Depositors' guaranty fund.—Banking corporations, which pursuant to the laws of the States in which they are doing business are required to set apart, keep and maintain in their banks the amount levied and assessed against them by the State authorities as a "Depositors' guaranty fund," may deduct from their gross income

the amount so set apart each year to this fund, provided that such fund, when set aside and carried to the credit of the State banking board or duly authorized State officer, ceases to be an asset of the bank and may be withdrawn in whole or in part upon demand by such board or State officer to meet the needs of these officers in reimbursing depositors in insolvent banks, and provided further that no portion of the amount thus set aside and credited is returnable under the laws of the State to the assets of the banking corporation. If, however, such amount is simply set up on the books of the bank as a reserve to meet a contingent liability and remains an asset of the bank, it will not be deductible except as it is actually paid out as required by law and upon demand of the proper State officers.

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

ART. 569. Required addition to reserve funds of insurance companies.—Insurance companies may deduct from gross income the net addition required by law to be made within the taxable year to reserve funds, including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds. This is considered to mean the net addition required by the specific statutes of the States within which the taxpayer transacts business. A requirement by a State insurance commissioner that a net addition shall be made to certain amounts retained to meet specified liabilities is not a net addition required by law to be made to reserve funds within the meaning of the statute. Only reserves commonly recognized as reserve funds in insurance accounting are to be taken into consideration in computing the net addition to reserve funds required by law. In the case of a fire insurance company the only reserve fund commonly recognized is the "unearned-premium" fund. Casualty companies may deduct losses incurred within the taxable year; but unless the net addition to the unpaid loss reserve required by law exceeds

such losses incurred, no deduction for the net addition to the unpaid loss reserve may be taken. In any event only the excess of such net addition over such losses may be deducted. In the case of life insurance companies the net addition to the "reinsurance reserve" and the "reserve for supplementary contracts not involving life contingencies", and the net addition to any other reserve funds necessarily maintained for the purpose of liquidating policies at maturity, are legally deductible. An increase in the reserve maintained by a life insurance company to pay dividends on deferred dividend policies may not be deducted from gross income. Mutual hail and mutual cyclone insurance companies are entitled to deduct from gross income the net addition which they are required to make to the "guaranty surplus" fund or similar fund.

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

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

ART. 572. Special deductions allowed mutual insurance companies.—Mutual insurance companies (other than mutual life and mutual marine insurance companies), which require their members to make premium deposits to provide for losses and expenses, are allowed to deduct from gross income the aggregate amount of premium deposits returned to their policyholders or retained for the payment of losses, expenses and reinsurance reserves. 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 cannot be separately deducted. An amount of premium deposits retained for the payment of expenses and losses, and the amount of such expenses and losses, may not both be deducted. A company which invests part of the premium deposits so retained by it in interest-bearing securities may nevertheless deduct such part, but not the interest received on such securities. A mutual fire insurance company which has a guaranty capital is taxed like other mutual fire insurance companies. A stock fire insurance company, operated on the mutual plan to the extent of paying dividends to certain classes of policyholders, may make a return on the same basis as a mutual fire insurance company with respect to its business conducted on the mutual plan.

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

ITEMS NOT DEDUCTIBLE.

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

ART. 581. Items not deductible.—No deduction from gross income may be made for any amounts paid out for new buildings or for permanent improvements or betterments made to increase the value of any property, or for any amounts expended in restoring property or in making good the exhaustion thereof for which an allowance for depreciation or depletion or other allowance is or has been made, or for any amounts paid for premiums on any life insurance policy

covering the life of an officer or employee or of any person financially interested in the business of the corporation when the corporation is directly or indirectly a beneficiary under such policy. See section 215 of the statute and articles 291-294.

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

CREDITS ALLOWED.

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

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

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

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

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

PAYMENT OF TAX AT SOURCE.

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

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

CREDIT FOR TAXES.

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

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

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

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

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

CORPORATION RETURNS.

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

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

ART. 621. Corporation returns.—Every corporation not expressly exempt from tax and every personal service corporation must make a return of income, regardless of the amount of its net income. In the case of ordinary corporations the return shall be on form 1120. For returns of insurance companies see article 623; of personal service corporations see article 624; of foreign corporations see article 625; and of affiliated corporations see section 240 of the statute and articles 631-638. A corporation having an existence

during any portion of a taxable year is required to make a return. A corporation which has received a charter, but has never perfected its organization, and which has transacted no business and had no income from any source, may upon presentation of the facts to the collector be relieved from the necessity of making a return so long as it remains in an unorganized condition. In the absence of a proper showing to the collector such a corporation will be required to make a return. A corporation which was dissolved in 1918 or 1919 prior to the enactment of the present statute is not relieved from the necessity of rendering returns thereunder for 1918 and for such portion of 1919 as elapsed before its dissolution. See further section 228 of the statute and articles 406, 407 and 451.

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

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

ART. 624. Returns of personal service corporations.—Every personal service corporation must make a return of income, regardless of the amount of its net income. The return shall be on form 1065 (revised). It shall be made for the taxable year of the personal service corporation; that is, for its annual accounting period (fiscal year or calendar year, as the case may be), regardless of the taxable years of its stockholders. See

sections 200, 212 and 218 of the statute and articles 1523-1532, 25, 26 and 328-335. If the personal service corporation makes any change in its accounting period it shall render its return in accordance with the provisions of section 226 of the statute and article 431. The return of a personal service corporation shall state specifically (a) the items of its gross income enumerated in section 213 of the statute; (b) the deductions enumerated in section 214 of the statute, other than the deduction provided in paragraph (11) of subdivision (a) of that section; (c) the 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; (f) the names and addresses of the stockholders of the corporation at the close of its taxable year and their respective shares in such corporation; (g) such facts as tend to show whether or not the corporation is a personal service corporation; and (h) such other facts as are required by the form. A personal service corporation which makes a return for a fiscal year beginning in 1917 shall include therein all the facts required for the computation of income and excess profits taxes under Title I of the Revenue Act of 1916, as amended by the Revenue Act of 1917, and under Titles I and II of the Revenue Act of 1917. See sections 205 and 335 of the statute and articles 1621-1625 and 951.

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

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

CONSOLIDATED RETURNS.

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

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

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

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

ART. 631. *Affiliated corporations.*—The provision of the statute requiring affiliated corporations to file consolidated returns is based upon the principle of levying the tax according to the true net income and invested capital of a single business enterprise, even though the business is operated through more than one corporation. Where one corporation owns the capital stock of another corporation or other corporations, or where the stock of two or more corporations

is owned by the same interests, a situation results which is closely analogous to that of a business maintaining one or more branch establishments. In the latter case, because of the direct ownership of the property, the invested capital and net income of the branch form a part of the invested capital and net income of the entire organization. Where such branches or units of a business are owned and controlled through the medium of separate corporations, it is necessary to require a consolidated return in order that the invested capital and net income of the entire group may be accurately determined. Otherwise opportunity would be afforded for the evasion of taxation by the shifting of income through price fixing, charges for services and other means by which income could be arbitrarily assigned to one or another unit of the group. In other cases without a consolidated return excessive taxation might be imposed as a result of purely artificial conditions existing between corporations within a controlled group. See articles 785, 791, 802 and 864-869.

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

ART. 633. When corporations are affiliated.—Corporations will be deemed to be affiliated (a) when one domestic corporation owns directly or controls through closely affiliated interests or by a nominee or nominees substantially all the stock of the other or others, or (b) when substantially all the stock of two or more domestic corporations

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

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

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

affiliated group being assessed on the basis of the remaining consolidated invested capital and net income. See section 1 of the statute and article 1510.

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

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

ART. 638. Different fiscal years of affiliated corporations.—In the case of all consolidated returns, consolidated invested capital must be computed as of the beginning of the taxable year of the parent or principal reporting company and consolidated income must be computed on the basis of its taxable year. Whenever the fiscal year of one or more subsidiary or other affiliated corporations differs from the

fiscal year of the parent or principal corporation, the Commissioner should be fully advised by the taxpayer in order that provision may be made for assessing the tax in respect of the period prior to the beginning of the fiscal year of the parent or principal company. See section 226 of the statute and article 431:

TIME AND PLACE FOR FILING RETURNS.

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

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

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

PART II B.

WAR PROFITS AND EXCESS PROFITS TAX.

GENERAL DEFINITIONS.

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

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

IMPOSITION OF TAX.

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

FIRST BRACKET.

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

SECOND BRACKET.

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

THIRD BRACKET.

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

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

FIRST BRACKET.

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

SECOND BRACKET.

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

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

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

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

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

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

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

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

ART. 712. Computation of tax for 1918.—For the taxable year 1918, (a) if the net income, as defined in section 320 (a) (3) of the statute, is not in excess of 20 per cent of the invested capital, as defined in section 326, then under the first bracket the tax is 30 per cent of the

amount of the net income in excess of the excess profits credit, as defined in section 312, and the second bracket is not applicable. (b) If the net income is in excess of 20 per cent of the invested capital, then under the first bracket the tax is 30 per cent of the excess of an amount of net income equal to 20 per cent of the invested capital over the excess profits credit, and under the second bracket the tax is 65 per cent of the amount of the remaining net income less any excess profits credit not exhausted under the first bracket. (c) If the tax under (a) or the aggregate tax under (b) equals or exceeds 80 per cent of the amount of the net income in excess of the war profits credit, as defined in section 311, then the tax under (a) or (b) is the amount of the tax payable. But if such tax is less than such 80 per cent, then the tax payable is 80 per cent of the amount of the net income in excess of the war profits credit. But see section 302 and articles 731-733.

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

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

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

ART. 716. Illustration of computation of tax.—

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

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

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

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

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

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

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

First bracket.—The amount or portion of the net income (\$50,000) in excess of the excess profits credit (\$11,800) and not in excess of 20 per cent of the invested capital (i. e., 20 per cent of \$110,000) or \$22,000 is \$10,200. The tax computed under this bracket is 20 per cent of this amount (i. e., 20 per cent of \$10,200) or \$2,040.

Second bracket.—The amount or portion of the net income (\$50,000) in excess of 20 per cent of the invested capital (i. e., 20 per cent of \$110,000) or \$22,000 is \$28,000. The tax computed under this bracket is 40 per cent of this amount (i. e., 40 per cent of \$28,000) or \$11,200.

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

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

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

Third bracket.—Eighty per cent of the amount of the net income in excess of the war profits credit (i. e., 80 per cent of the amount by which \$40,000 exceeds \$28,000 or 80 per cent of \$12,000) is \$9,600. The amount of the tax computed under the first and second brackets (\$2,700 plus \$13,000) is \$15,700. There is accordingly no tax under the third bracket, as \$9,600 does not exceed \$15,700.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

A corporation which has reported on the basis of the fiscal year ending March 31, 1918, later changes to a calendar year basis and files a return covering the 9 months from April 1, 1918, to December 31, 1918. It had an average prewar capital of \$50,000, an average prewar net income of \$3,500, an invested capital for the 9 months ending December 31, 1918, of \$120,000, and a net income for such period of \$50,000. The computation in this illustration follows the directions contained in return form 1120 and proportionately reduces items 3 and 8 of schedule III and items 1 and 2 of column 2 of schedule IV. It should be noted that this is a somewhat different method of arriving at the same result which would be reached under a literal application of sections 305, 311 (a) (2) and 326 (d) of the statute. The excess profits credit is computed by adding the specific exemption of \$3,000 and 8 per cent of the full invested capital of \$120,000, or \$9,600, a total of \$12,600, and taking $\frac{9}{12}$ of this result, or \$9,450, as the excess profits credit. See item 3 of schedule III of form 1120. The war profits credit is computed by adding the specific exemption of \$3,000 to 10 per cent of the full invested capital of \$120,000, or \$12,000, a total of \$15,000, and taking $\frac{9}{12}$ of this

result, or \$11,250, as the war profits credit. See item 8, of schedule III of form 1120. The war profits credit is computed in this case under section 311 (b), because the amount computed under section 311 (a) (2) is less than 10 per cent of the invested capital. The amount computed under section 311 (a) (2) would be the sum of the average prewar net income, or \$3,500, plus 10 per cent of the amount by which the full invested capital of \$120,000 actually used during the taxable period exceeds the average prewar invested capital of \$50,000 (i. e., 10 per cent of \$70,000), or \$7,000, a total of \$10,500. See items 4 and 5 of schedule III of form 1120. This amount is less than 10 per cent of the full invested capital for the taxable year as computed under section 311 (b). See item 6 of schedule III of form 1120.

First bracket.—The amount or portion of the net income (\$50,000) in excess of the excess profits credit (\$9,450) and not in excess of 9/12 of 20 per cent of the invested capital (i. e., 9/12 of 20 per cent of \$120,000), or \$18,000, is \$3,550. The tax computed under this bracket is 30 per cent of this amount (i. e., 30 per cent of \$3,550), or \$2,565.

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

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

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

LIMITATION OF TAX.

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

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

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

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

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

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

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

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

TAX WHEN PARTLY PERSONAL SERVICE BUSINESS.

SEC. 303. That if part of the net income of a corporation is derived (1) from a trade or business (or a branch of a trade or business) in which the employment of capital is necessary, and (2) a part (constituting not less than 30 per centum of its total net income) is derived from a separate trade or business (or a distinctly separate branch of the trade or business) which if constituting the sole trade or business would bring it within the class of "personal service corporations," then (under regulations prescribed by the Commissioner with the approval of the Secretary) the tax upon the first part of such net income shall be separately computed (allowing in such computation only the same proportionate part of the credits authorized in sections 311 and 312), and the tax upon the second part shall be the same percentage thereof as the tax so computed upon the first part is of such first part: *Provided*, That the tax upon such second part shall in no case be less than 20 per centum thereof, unless the tax upon the entire net income, if computed without benefit of this section, would constitute less than 20 per centum of such entire net income, in which event the tax shall be determined upon the entire net income, without reference to this section, as other taxes are determined under this title. The total tax computed under this section shall be subject to the limitations provided in section 302.

ART. 741. Apportionment of invested capital and net income.—For the purpose of determining whether or not a corporation partly partaking of the nature of a personal service corporation is within the scope of section 303 of the statute and also for the purpose of establishing the basis for the computation of the tax, the corporation shall apportion or allocate its invested capital between each trade or business or branch thereof as nearly as may be in accordance with the actual facts, and shall submit with its return an explanatory statement setting forth the manner in which the apportionment of the invested capital employed in the production of each part of its net income has been determined. There must be assigned to any personal service trade or business or branch thereof an amount of

invested capital at least as great as that which would ordinarily be employed by a personal service corporation of similar size and standing for the payment of salaries and office expenses, maintenance of library and equipment, credit advances to clients, etc. For the method of determining the portion of the net income derived from each trade or business or branch thereof see article 715. For the definition of "personal service corporation" see articles 1523-1532.

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

(2) The tax upon the personal service part of the net income is the same percentage thereof as the tax computed under (1) is of the non-personal service part of the net income. The tax under this paragraph shall in no case be less than 20 per cent of the personal service part of the entire net income, unless the tax upon the entire net income if computed in the ordinary way would be less than 20 per cent of such entire net income. In that event, and in any case in which the amount of the total tax as computed under this article is the same as or greater than the tax as computed in the ordinary way, the tax shall be computed under section 301 of the statute. See section 302 and articles 711-720 and 731-733.

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

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

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

First bracket.—The amount of the net income derived from contracting (\$30,000) in excess of the excess profits credit (\$7,480) and not in excess of 20 per cent of the invested capital (i. e., 20 per cent of \$81,000) or \$16,200 is \$3,720. The tax under this bracket is 30 per cent of this amount (i. e., 30 per cent of \$3,720) or \$2,616.

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

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

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

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

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

EXEMPTIONS.

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

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

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

ART. 751. Corporations exempt from tax.—A corporation whose net income for a full taxable year of twelve months is less than \$3,000 is exempt from the tax. If the taxable period is less than twelve months the corporation is exempt from the tax if its net income for the period is less than the same proportion of \$3,000 as the number of months in the period is of twelve months, any fractional part of a month being counted as the number of days in such part of a

month divided by 30. Certain classes of corporations, including personal service corporations, named in section 231 of the statute are also exempt. See articles 511-522.

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

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

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

APPORTIONMENT OF SPECIFIC EXEMPTION.

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

ART. 761. Apportionment of specific exemption.—The specific exemption of \$3,000 is apportioned only in the case where a return is made covering a period of less than twelve months. In such a case the specific exemption is the same proportion of \$3,000 as the number of months in the period is of twelve months, any fractional part of a month being counted as the number of days in such part of a month divided by 30. Thus, in the case of a corporation organized May 12, 1918, and making a return for the period ending December 31, 1918, the exemption is \$1,916.67, that is, the same proportion of \$3,000 as $7\frac{2}{3}$ months is of 12 months. On return form 1120 this apportionment is taken care of by prorating items 3 and 8 of schedule III. This provision is inapplicable where the return is made for a full fiscal year beginning prior to January 1, 1918, and ending after that date, even though the income for such fiscal year is not subject to full taxation under the present statute.

PREWAR PERIOD.

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

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

WAR PROFITS CREDIT.

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

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

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

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

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

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

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

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

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

(d) The war-profits credit shall be determined in the manner provided in subdivision (b) instead of in the manner provided in subdivision (c), in the case of any corporation which was not in existence during the whole of at least one calendar year during the prewar period, if (1) a majority of its stock at

any time during the taxable year is owned or controlled, directly or indirectly, by a corporation which was in existence during the whole of at least one calendar year during the prewar period, or if (2) 50 per centum or more of its gross income (as computed under section 233 for income tax purposes) consists of gains, profits, commissions, or other income, derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

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

ART. 781. War profits credit.—Ordinarily the war profits credit consists of the sum of the specific exemption of \$3,000 and an amount equal to the average net income of the corporation for the prewar period, plus 10 per cent of the excess of the invested capital for the taxable year over the average invested capital for the prewar period, or minus 10 per cent of the excess of the average invested capital for the prewar period over the invested capital for the taxable year. If a return is made for a period of less than twelve months, the amount equal to the average net income for the prewar period plus or minus 10 per cent of the difference between the average invested capital for the prewar period and the invested capital for the taxable year shall be reduced to the same proportion thereof as the number of months in the period is of twelve months. See section 305 of the statute and article 761. The same result is reached in schedule IV of return form 1120 by computing the war profits credit for a full year and taking a fractional part of the result. If at the time a return is made the net income for the prewar period or the difference between the average invested capital for the prewar period and the invested capital for the taxable year can not be determined, the war profits credit shall be computed in the first instance as provided in the following article. If either of these amounts can not eventually be determined, the war profits credit shall be finally determined as provided in the following article. See also section 327 and articles 716-720, 743 and 901.

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

ART. 783. War profits credit where no prewar period.—If a corporation had no prewar period, then the war profits credit consists of the sum of the specific exemption of \$3,000 and an amount equal to the same percentage of the invested capital for the taxable year as the average percentage of net income to invested capital for the

prewar period of corporations engaged in a trade or business of the same general class as that conducted by the taxpayer, but not less than 10 per cent of its invested capital for the taxable year. The war profits credit shall be computed in the first instance on the basis of 10 per cent of the invested capital, and when the average percentage of corporations engaged in the same general class of trade or business has been determined the amount of the tax will if necessary be recomputed. See section 250 of the statute and articles 784 and 1001.

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

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

EXCESS PROFITS CREDIT.

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

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

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

NET INCOME.

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

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

(2) For the calendar year 1913 upon the same basis and in the same manner as provided in Section II of the Act entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," ap-

proved October 3, 1913, except that taxes imposed by section 88 of such Act of August 5, 1909, and paid by the corporation within the year shall be included, and except that the amounts received by it as dividends upon the stock or from the net earnings of other corporations subject to the tax imposed by Section II of such Act of October 3, 1913, shall be deducted; and

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

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

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

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

TERMS RELATING TO INVESTED CAPITAL.

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

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

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

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

The term "inadmissible assets" means stocks, bonds, and other obligations (other than obligations of the United States), the dividends or interest

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

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

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

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

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

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

general creditors, the amount so left with the corporation must be considered as borrowed capital and be so treated in computing invested capital.

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

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

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

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

ART. 818. Admissible assets.—Admissible assets include all assets other than inadmissible assets. Organization expenses and deferred charges against future income are admissible assets. For all purposes of computing invested capital admissible assets must be valued

in accordance with the provisions of sections 326, 330 and 331 of the statute and the articles thereunder. Thus, for example, intangible property paid in for stock or shares is an admissible asset, but it cannot be valued at an amount in excess of that at which it may be included in computing invested capital under paragraphs (4) and (5) of section 326 (a).

INVESTED CAPITAL.

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

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

(2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor, unless the actual cash value of such tangible property at the time paid in is shown to the satisfaction of the Commissioner to have been clearly and substantially in excess of such par value, in which case such excess shall be treated as paid-in surplus: *Provided*, That the Commissioner shall keep a record of all cases in which tangible property is included in invested capital at a value in excess of the stock or shares issued therefor, containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, the value of the tangible property at the time paid in, the par value of the stock or shares specifically issued therefor, and the amount included under this paragraph as paid-in surplus. The Commissioner shall furnish a copy of such record and other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257;

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

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

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

(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 (except for the purpose of paragraph (2) of subdivision (a) of section 311) be the same fractional part of such average invested capital.

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

ART. 831. Meaning of invested capital.—Invested capital within the meaning of the statute is the capital actually paid in to the corporation by the stockholders, including the surplus and undivided profits, and is not based upon the present net worth of the assets, as shown by an appraisal or in any other manner. The basis or starting point in the computation of invested capital is found in the amount of cash and other property paid in, the valuation at which such other property may be included being determined in accordance with the statute and the regulations. The computation does not stop, however, with such original entries or amounts, but also takes into account the surplus and undivided profits of prior years left in the business. The invested capital of a corporation includes, generally speaking, (a) the cash paid in for stock, (b) the tangible property paid in for stock, (c) the surplus and undivided profits, and (d) the intangible property paid in for stock (to a limited amount), less, however, the same proportion of such aggregate sum as the amount of inadmissible assets bears to the total assets. 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.—Enforceable notes or other evidences of indebtedness, either interest-bearing or non-interest bearing, of the subscriber received by a corporation upon a subscription for stock may be considered as tangible property in computing its invested capital to the extent of the actual cash value of such notes or other evidences of indebtedness at the time when paid in, but only (a) if such notes or evidences of indebtedness could under the laws of the jurisdiction in which the corporation was organized legally be received in payment for stock,

and (b) if they were actually received by the corporation as absolute, and not as conditional, payment in whole or in part of the stock subscription.

ART. 834. **Tangible property paid in: inadmissible assets.**—Stocks, bonds and other obligations (other than obligations of the United States), the dividends or interest from which are not included in computing net income, when bona fide paid in for stock or shares may like other tangible property be included in computing the invested capital of the corporation at their actual cash value when paid in. For the purpose of the reduction required in articles 852 and 854, however, account must be taken of such assets in the same manner as of any other inadmissible assets.

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

ART. 836. **Tangible property paid in: value in excess of par value of stock.**—Evidence offered to support a claim for a paid-in surplus must be as of the date of the payment, and may consist among other things of (a) an appraisal of the property by disinterested authorities made on or about the date of the transaction; (b) certification of the assessed value in the case of real estate; and (c) proof of a market price in excess of the par value of the stock or shares. The additional value allowed in any case is confined to the value definitely known or accurately ascertainable at the time of the payment. No claim will be allowed for a paid-in surplus in a case in which the additional value has been developed or ascertained subsequently to the date on which the property was paid in to the corporation, or in respect of property which the stockholders or their agents on or shortly before the date of such payment acquired at a bargain price, as for instance, at a receiver's sale. Generally, allowable claims under this article will arise out of transactions in which there has been no substantial change of beneficial interest in the property paid in to the corporation, and in all cases the proof of value must be clear and explicit.

ART. 837. Surplus and undivided profits: paid-in surplus.—Where it is shown by evidence satisfactory to the Commissioner that tangible property has been paid in by a stockholder to a corporation as a gift or at a value definitely known or accurately ascertainable as of the date of such payment clearly and substantially in excess of the cash or other consideration paid by the corporation therefor, then the amount of the excess shall be deemed to be paid-in surplus. Substantially the same kind of evidence will be required under this article as under article 836. See further article 813.

ART. 838. Surplus and undivided profits: earned surplus.—Only true earned surplus and undivided profits can be included in the computation of invested capital, and if for any reason the books do not properly reflect the true surplus such adjustments must be made as are necessary in order to arrive at the correct amount. In the computation of earned surplus and undivided profits full recognition must first be given to all expenses incurred and losses sustained from the original organization of the corporation down to the taxable year, including among such expenses and losses reasonable allowances for depreciation, obsolescence or depletion of property (irrespective of the manner in which such property was originally acquired), and for the amortization of any discount on its bonds. There can of course be no earned surplus or undivided profits until any deficit or impairment of paid-in capital due to depletion, depreciation, expense, losses or any other cause has been made good. Where adequate evidence is presented that the amounts written off or deducted in previous returns of net income are in the aggregate incorrect or unreasonable, adjustments must be made, and the taxpayer will be allowed a refund in respect of any taxes overpaid in prior years, or in the case of an underpayment of taxes will be additionally assessed.

ART. 839. Surplus and undivided profits: allowance for depletion and depreciation.—Depletion, like depreciation, must be recognized in all cases in which it occurs. Depletion attaches to each unit of mineral or other property removed, and the denial of a deduction in computing net income under the Act of August 5, 1909, or the limitation upon the amount of the deduction allowed under the Act of October 3, 1913, does not relieve the corporation of its obligation to make proper provision for depletion of its property in computing its surplus and undivided profits. Adjustments in respect of depreciation or depletion in prior years will be made or permitted only upon the basis of affirmative evidence that as at the beginning of the taxable year the amount of depreciation or depletion written off in prior years was insufficient or excessive, as the case may be. Where deductions for depreciation or depletion have either on the books of the corporation or in its returns of net income been included in the past in expense or other accounts, rather than specifically as deprecia-

tion 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 accounts will be presumed to show the facts. If it claims that its capital or surplus account is understated the burden of proof will rest upon it. Additions to such accounts will be accepted to the following extent:

(1) Excessive depreciation heretofore charged off on property still owned and in use, if it is now shown by satisfactory proof to have been excessive and such excess is substantial in amount, whether or not disallowed by the Commissioner as a deduction from net income, may be restored to the surplus account. No such amount shall be restored, however, unless it is shown that adequate depreciation has been deducted upon all other property of the corporation still in use, nor in any case in which such amount has been allowed as a deduction for amortization under section 234 (a) (8) of the statute, or in which the cost of the property has been recovered through being included in the price of goods or services, as for example, in the case of patterns, dies, plates, special tools, etc., or under a munition contract with a foreign government.

(2) Amounts which have been expended before January 1, 1917, for the acquisition of plant, equipment, tools, patterns, furniture, fixtures, or like tangible property, having a useful life extending substantially beyond the year in which the expenditure was made, and which have been charged as current expense, may (less proper deductions for depreciation or obsolescence) be added to the surplus account when such assets are still owned and in active use by the corporation during the taxable year. Special tools, patterns, and similar assets shall not be assigned any value if their cost has been recovered through having been included in the price of goods. If their cost has not been so recovered and they are held for only occasional use, they shall not be assigned a value in excess of the fair value based upon the earnings actually arising from their current use, and in no case shall such value be more than the cost less depreciation. Assets of this kind not in current use shall not be valued at more than their nominal or scrap value.

(3) Amounts which have been expended in the past for intangible property of any kind can be restored to capital or surplus account only to the extent that the corporation specifically paid such amounts for the intangible property as such. For provisions relating to patents see article 843.

(4) Adjustments necessary to correct other errors found in the books of account may be made. But see the following article.

ART. 841. Surplus and undivided profits: limitation of additions to surplus account.—Additions to surplus which a corporation may desire to make under the preceding article fall broadly into two classes:

(1) To correct returns of net income for prior years in which actual errors have been made, as for example where excessive depreciation has been deducted, additions to plant and equipment or other capital charges have been charged off as an expense, inventories have been taken upon a wrong basis of valuation, etc.

(2) To reinstate in surplus deductions from income which are as a matter of good accounting to some extent optional, such as experimental expenses, patent litigation, development of good will through advertising or otherwise, etc.

Adjustments falling in class (1) will be permitted for all years whether before or after March 1, 1913, provided amended returns of net income are filed for each year in which an erroneous return has been made. Due consideration will be given to the assessment of penalties in any case in which a fraudulent return has been made. Adjustments falling in class (2) cannot be permitted, as in such cases it is considered that the corporation has exercised a binding option in deducting such expenses from income. An election of this sort which was made concurrently with the transaction cannot now be revised, and amended returns in respect thereof cannot be accepted. The corporation shall submit with its return a statement of the additions proposed, specifying the kinds and amounts of property involved, the years in which the expenditures were made, and the method followed in distinguishing between capital outlays and current expenses, and showing that adequate provision has been made for depreciation, obsolescence and depletion of such of the assets affected by the additions as are subject to recognized depreciation, obsolescence or depletion. In any case in which there is an operating deficit amounts restored must first be set off against the deficit and only the excess can be actually included in the computation of invested capital.

ART. 842. Surplus and undivided profits: property paid in and subsequently written off.—Where tangible or intangible property has been paid in to a corporation for stock or shares or as paid-in surplus, and has subsequently been in whole or in part written off the books, the amount so written off may upon evidence satisfactory to the Commissioner be restored to the capital or surplus account subject to the following limitations:

(1) The amount restored must be reduced by a proper deduction for any depreciation, obsolescence or depletion; and

(2) The aggregate amount included in computing invested capital on account of such property shall not exceed the amount which might have been included if such property had not been written off.

ART. 843. Surplus and undivided profits: patents.—From the standpoint of assets a patent, or more particularly a group of patents, is closely analogous to good will. Their value is contingent upon and measured by their earning power. While patents have a definite life, there is a common tendency to extend that life by improvements upon the original, and in a successful business the patent value merges more or less completely into a trade name or other form of good will. Therefore, while deductions in respect to the depreciation of patents based upon a normal life period of seventeen years are allowable in computing net income for the purpose of the income tax, such deductions are not obligatory, but are optional with each taxpayer. Where since January 1, 1909, a corporation has exercised that option to its own benefit in computing its taxable net income the amount so deducted can not now be restored in computing invested capital. Where, however, the cost of patents has been charged against surplus or otherwise disposed of in such a manner as not to benefit the corporation in computing its taxable net income since January 1, 1909, any amount so written off may be restored in computing invested capital, if it be shown to the satisfaction of the Commissioner that the amount so written off represented a mere book entry ascribable to a conservative policy of management or accounting and did not represent a realized shrinkage in the value of such assets. Any amount so restored may not be written off by way of deductions from taxable net income in any subsequent year or years. Where a corporation has charged to current expenses the cost of developing or protecting patents, no amount in respect thereof expended since January 1, 1909, can be restored in computing invested capital. In respect of expenditures made before January 1, 1909, a corporation now seeking to restore them must be prepared to show to the satisfaction of the Commissioner that all such items are proper capital expenditures. It can not be said that the correct computation of surplus and undivided profits necessarily requires a deduction in respect of the expiration of patents. It follows, therefore, that where a corporation in the exercise of its option has not written down the cost of patents, it is not ordinarily necessary to reduce the surplus and undivided profits in computing invested capital, whether the patents have been acquired for stock or shares or for cash or other tangible property. Due consideration will be given to the facts in any case in which this rule seems obviously unreasonable. See article 167.

ART. 844. Surplus and undivided profits: reserve for depreciation or depletion.—If any reserves for depreciation or for depletion are included in the surplus account it should be analyzed so as to separate such reserves and leave only real surplus. Reserves for

depreciation or depletion can not be included in the computation of invested capital, except to the following extent:

(1) Excessive depletion or depreciation included therein and which if charged off could be restored under article 840 may be included in the computation of invested capital; and

(2) Where depreciation or depletion is computed on the value as of March 1, 1913, or as of any subsequent date, the proportion of depreciation or depletion representing the realization of appreciation of value at March 1, 1913, or such subsequent date, may if undistributed and used or employed in the business be treated as surplus and included in the computation of invested capital.

For the purpose of computing invested capital depreciation or depletion computed on the value as of March 1, 1913, or as of any subsequent date shall, if such value exceeded cost, be deemed a pro rata realization of cost and appreciation and be apportioned accordingly. Except as above provided value appreciation (even though evidenced by an appraisal) which has not been actually realized and in respect of amounts accrued since March 1, 1913, reported as income for the purpose of the income tax, can not be included in the computation of invested capital, and if already reflected in the surplus account it must be deducted therefrom.

ART. 845. Surplus and undivided profits: reserve for income and excess profits taxes.—For the purpose of computing invested capital federal income and war profits and excess profits taxes are deemed to have been paid out of the net income of the taxable year for which they are levied. It is immaterial, therefore, whether reserves for the payment of such taxes for the preceding year have been set up or not, or if set up whether such taxes when paid have actually been charged against such reserves. Amounts payable on account of such taxes for the preceding year may be included in the computation of invested capital only until such taxes become due and payable. A deduction from the invested capital as of the beginning of the taxable year must therefore be made for such taxes or any installment thereof, averaged for the proportionate part of the taxable year after the date when the tax or the installment is due and payable. Where as a result of an audit by the Commissioner, or the acceptance of an amended return, or for any other reason, the amount of any such tax for the preceding year is subsequently changed, a corresponding adjustment will be made in the invested capital for the taxable year upon the same basis as if the corrected amount of the tax for the preceding year had been used in the original computation of the invested capital for the taxable year. See articles 1541 and 1542.

ART. 846. Surplus and undivided profits: insurance on officers.—Where insurance is carried by the corporation on the life of an officer or employee, the policy may be included as an admissible

asset and reflected in the surplus account at the cash surrender value as of the beginning of the taxable year. The whole amount of premiums paid on such insurance can not be included in surplus, but the surplus will be considered as increased as of the beginning of each taxable year by the amount added to the cash surrender value of the policy. See article 294,

ART. 847. Surplus and undivided profits: property taken for debt or in exchange.—Real or personal property taken by a corporation in payment or satisfaction of a debt, or property received in exchange for other property, will be an admissible asset at its fair market value upon receipt. The profit or loss, if any, resulting from the transaction will not be reflected in invested capital until the succeeding taxable year. But see as to the foreclosure of a mortgage article 153. See also section 202 of the statute and articles 1561–1570.

ART. 848. Surplus and undivided profits: discount on sale of bonds.—Discount allowed on the sale of bonds is in effect an advance on account of interest, so that the effective rate of interest in such a case is equal to the sum of the nominal rate plus the rate necessary to amortize the discount over the life of the bonds. Where, under incorrect accounting practices, the discount on bonds has been charged to a property account or otherwise carried as an asset, and is so reflected in the surplus account, it is necessary in computing invested capital to make an adjustment in respect of such discount. See article 563.

ART. 849. Surplus and undivided profits: miscellaneous.—Only the amount of discount which has actually been reported by a bank in a prior year as taxable income and credited to surplus account may be included in surplus as of the beginning of the taxable year. For the treatment of surplus arising out of sales on the installment plan see articles 42–46, and from compensation for property lost, damaged or condemned see articles 49 and 50.

ART. 850. Surplus and undivided profits: current profits.—Profits earned during any year can not be included in the computation of invested capital for that year, even though during the year such profits are set up as surplus on the books or assumed to be distributed in the form of stock dividends. If a dividend is declared and paid during any year out of the profits of that year and the stockholders pay back into the corporation all or a substantial part of the amount of such dividends, the amount so paid back can not be included in the computation of invested capital unless the corporation shows by evidence satisfactory to the Commissioner that the dividends were paid in good faith and without any understanding, express or implied, that they were to be paid back.

ART. 851. Intangible property paid in.—The actual cash value of intangible property paid in for stock or shares must be determined in the light of the facts in each case. Among the factors to be con-

sidered are (a) the earnings attributable to such intangible assets while in the hands of the predecessor owner; (b) the earnings of the corporation attributable to the intangible assets after the date of their acquisition; (c) representative sales of the stock of the corporation at or about the date of the acquisition of the intangible assets; and (d) any cash offers for the purchase of the business, including the intangible property, at or about the time of its acquisition. A corporation claiming a value for intangible property paid in for stock or shares should file with its return a full statement of the facts relating to such valuation. See also article 835.

ART. 852. Percentage of inadmissible assets.—For the purpose of ascertaining the deductible percentage the amount of inadmissible assets held during the year may ordinarily be determined by dividing by two the sum of the amount of such assets held at the beginning of the year and the amount held at the end of the year. The total amount of admissible and inadmissible assets held during the year may ordinarily be determined by dividing by two the sum of the amount of such assets held at the beginning of the year and the amount at the end of the year. If at any time a substantial change has taken place either in the amount of inadmissible assets or in the total amount of admissible and inadmissible assets, the effect of such change shall be averaged exactly from the date on which it occurred. In any case where the Commissioner finds that either amount determined as above provided does not substantially reflect the average situation throughout the year, and that the amount of each kind of assets held on a given day of each month throughout the year or at more frequent regular intervals can be determined, the amount of inadmissible assets and the amount of both kinds of assets held during the year shall be determined by averaging the amounts held at such several times. In making the computations under this article the valuation at which each asset is carried shall be adjusted in accordance with the provisions of the statute and of the regulations relating to the valuation of assets for the purpose of computing invested capital, including in such adjustment the amount of reserves for depreciation, depletion, amortization and other reserves which represent the valuation of assets. It is immaterial whether any asset was acquired out of invested capital or out of profits earned during the year or borrowed capital.

ART. 853. Changes in invested capital during year.—The invested capital as of the beginning of any period of one year or less should be adjusted by an appropriate addition or deduction for each change in invested capital during the period. The amount so added or deducted in each case is the amount of the change averaged for the time remaining in the period during which it is in effect. The fraction used in finding such average is the number of days remaining

in the period (including the day on which the change occurs) over the number of days in the period. Thus if a return is made for the calendar year ending December 31, 1918, and if \$100,000 of additional capital was paid in on February 17, 1918, this addition to invested capital is in effect for 318 days, and the amount to be added to the invested capital as of the beginning of the year would be $\frac{318}{365}$ of \$100,000, or \$87,123.29. If \$50,000 of this amount was withdrawn on October 31, 1918, the amount to be deducted would be $\frac{62}{365}$ 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 for any year during the prewar period is determined in the same manner as for the taxable year. The invested capital can not be determined by adding the amounts of the assets of a corporation.

ART. 855. Invested capital for full year or less.—In the case of a corporation making a return for a full year of 12 months, its invested capital for the year is the average invested capital for the year. In the case of a corporation making a return for a fractional part of a year, its invested capital for such period is the same fractional part of the average invested capital for such period, except that for the purpose of section 311 (a) (2) of the statute it is the full average invested capital for the period. In computing the tax under a return for a fractional part of a period the same purpose may sometimes be more readily effected by using the full average invested capital and taking a fractional part of the result, as in schedule III of form 1120. In schedule IV of the same form, however, the fractional part of the full average invested capital for the period should be used. See articles 720 and 853.

ART. 856. Illustration of invested capital for fractional part of year.—

A corporation was organized July 1, 1918, and makes a return for the six months ending December 31, 1918. The invested capital consists of \$100,000 paid in on July 1 and \$100,000 paid in on October 1. The average invested capital for such period would be \$100,000 plus $\frac{92}{184}$ (not $\frac{92}{365}$) of \$100,000, or \$50,000, a total of \$150,000. The invested capital for the period for the purpose of the tax would, however, be $\frac{6}{12}$ of \$150,000, or \$75,000. But see section 311 (a) (2) of the statute.

ART. 857. Method of determining available net income.—Whether at the time of any payment made during the taxable year there is sufficient income of the taxable year available for such payment, or whether the surplus or undivided profits as of the beginning of the taxable year must be reduced by the amount of such payment, shall be determined according to the following principles:

(1) The aggregate amount of earnings of the taxable year available for all purposes up to any given date will be determined upon the basis of the same proportion of the net income for the taxable year (as finally determined for the purpose of income and war profits and excess profits taxes) as the part of the year already elapsed is of the entire year (determined in the manner provided in article 853), unless the corporation shows from its books or other records that a greater proportion of its earnings for the year was available on such date.

(2) The aggregate amount available will be deemed to be applied for the following purposes in the order in which they are stated: (a) accrued federal income and war profits and excess profits taxes for the taxable year (see article 845), and (b) dividends paid after the expiration of the first sixty days of the taxable year (see section 201 of the statute and article 1541) and other corporate purposes, including the purchase of outstanding stock of the corporation previously issued (see article 862). In any case where the above computation would be indeterminate because of the effect of the provisions of this article upon the invested capital for the year, the amount of such invested capital for the purpose of this computation may be deemed to be the invested capital as of the beginning of the taxable year, plus any additional capital paid in during such year and minus any specific withdrawal or liquidation of capital during such year.

ART. 858. Effect of ordinary dividend.—A dividend other than a stock dividend affects the computation of invested capital from the date when the dividend is payable and not from the date when it is declared, except that where no date is set for its payment the date when declared will be considered also the date when payable for the purpose of this article. For the purpose of computing invested capital a dividend paid after the expiration of the first sixty days of the taxable year will be deemed to be paid out of the net income of the taxable year to the extent of the net income available for such purpose on the date when it is payable. See article 857. The surplus and undivided profits as of the beginning

of the taxable year will be reduced as of the date when the dividend is payable by the entire amount of any dividend paid during the first sixty days of the taxable year and by the amount of any other dividend in excess of the current net income available for its payment. In the case of a dividend paid during the first sixty days of a taxable year which exceeds in amount the surplus and undivided profits as of the beginning of the taxable year the excess will be deemed to be paid out of earnings of the taxable year available at the date when the dividend is payable, and to the extent that such earnings are insufficient it will be deemed to be a liquidation of paid in capital or surplus. From the date when any dividend is payable the amount which the several stockholders are entitled to receive will be treated as if actually paid to them, whether or not it is so paid in fact, and the surplus and undivided profits, either of the taxable year or of the preceding years, will in accordance with the foregoing provisions be deemed to be reduced as of that date by the full amount of the dividend. Amounts paid to stockholders in anticipation of dividends, or amounts withdrawn by stockholders in excess of dividends declared, will in computing invested capital have the same effect as if actually paid as dividends. See also article 813, and see generally section 201 and articles 1541-1549.

ART. 859. Effect of stock dividend.—The payment of a stock dividend has no effect upon the amount of invested capital. Such items as appraised value of good will, appreciation in value of real estate or other tangible property, etc., although carried to surplus and distributed as stock dividends, can not in this manner be capitalized and included in computing invested capital. If a corporation has paid a stock dividend in excess of its true surplus, it can not be deemed to have any greater invested capital than could have been computed had no such stock dividend been paid.

ART. 860. Impairment of capital.—Capital or surplus actually paid in is not required to be reduced because of an impairment of capital in the nature of an operating deficit, except where there has been directly or indirectly a liquidation or return of their investment to the stockholders, in which case full effect must be given to any liquidation of the original capital.

ART. 861. Surrender of stock.—Where stock which has originally been issued or exchanged by the corporation for property (tangible or intangible) is returned to the corporation as a gift or for a consideration substantially less than its par value, the stock so returned shall not be treated as a part of the stock issued or exchanged for such property. The proceeds derived in cash or its equivalent from the resale of the stock so returned shall, however, be included in computing invested capital. See article 542.

ART. 862. Purchase of stock.—Where a corporation either directly or indirectly, as for example through a trustee, has prior to the taxable year bought its own stock, either for the purpose of retirement or of holding it in the treasury or for other purposes, the entire cost of such stock must be deducted from the aggregate invested capital as of the beginning of the taxable year, if such deduction has not already been made. Where such stock is purchased during the taxable year a deduction from the invested capital as of the beginning of the taxable year and effective from the date of such purchase is required only to the extent that such stock has not been purchased out of the undivided profits of the taxable year. See article 857. The full amount derived in cash or its equivalent from the resale of such stock may be included in the invested capital from the date of such resale, unless such stock had been purchased out of earnings of the taxable year. See article 542.

ART. 863. Invested capital and other measures of capital.—(a) The invested capital as here defined may differ from the capital as shown on the books of the corporation. In such event no changes should be made in the books themselves. The corporation should, however, in all cases keep a permanent record of the adjustments which are made in computing invested capital. (b) Section 1000 of the statute imposes a tax on the fair value of the capital stock of corporations. As in the case of the war profits and excess profits tax the invested capital is based upon the actual investment of the stockholders in the corporation, irrespective of the present value of its assets, and in the case of the capital stock tax the fair value looks to the present value of the corporation's assets, irrespective of the amount of the investment of the stockholders therein, the amount determined as the fair value of the capital stock for the purpose of the capital stock tax can have no bearing upon the determination of invested capital. See also article 1561.

ART. 864. Affiliated corporations: invested capital.—The invested capital of affiliated corporations, as defined in section 240 (b) of the statute and article 633, for the taxable year is the invested capital of the entire group treated as one unit operated under a common control. As a first step in the computation a consolidated balance sheet should be prepared in accordance with standard accounting practices, which will reflect the actual assets and liabilities of the affiliated group. In preparing such a balance sheet all intercompany items, such as intercompany notes and accounts receivable and payable, should be eliminated from the assets and the liabilities, respectively, and proper adjustments should be made in respect of intercompany profits or losses reflected in inventories which at the beginning or end of the taxable year contain merchandise exchanged between the corporations included in the affiliated group at prices above or below cost to the producing or original owner corporation. Such con-

solidated 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 not owned by the parent or principal company, together with the surplus, if any, belonging to such minority interest. In computing consolidated invested capital the starting point is furnished by the total of the amounts shown under (a), (b) and (c) above. This total must be increased or diminished by any adjustments required to be made under the provisions of sections 325, 326, 330 and 331 of the statute and articles 811-818, 831-869, 931-934 and 941 of the regulations, except as otherwise provided in articles 865-868.

ART. 865. Affiliated corporations: intangible property paid in.—

(1) In respect of corporations whose affiliation is in the nature of parent and subsidiary companies: (a) in the case of intangible property bona fide paid in for stock or shares prior to March 3, 1917, there may be included in invested capital an amount not exceeding the actual cash value of such property at the time paid in, or the par value of the stock or shares issued therefor, or in the aggregate 25 per cent of the par value of the total stock or shares of the consolidation outstanding on March 3, 1917 (determined as indicated in items (a) and (c) in article 864), or in the aggregate 25 per cent of the par value of the total stock or shares shown on the consolidated balance sheet, being the amount of the capital stock included in items (a) and (c) in article 864 at the beginning of the taxable year, whichever is lowest; and (b) in the case of intangible property bona fide paid in for stock or shares on or after March 3, 1917, there may be included in invested capital an amount not exceeding the actual cash value of such property at the time paid in, or the par value of the stock or shares issued therefor, or in the aggregate 25 per cent of the par value of the total stock or shares shown by the consolidated balance sheet, being the amount of the capital stock included in items (a) and (c) in article 864 outstanding at the beginning of the taxable year, whichever is lowest. (c) When intangible property has been acquired in part before and in part after March 3, 1917, the amounts shall be ascertained, respectively, under (a) and (b) above and in the aggregate shall in no case exceed 25 per cent of the par value of the total stock or shares outstanding at the beginning of the taxable year shown in the consolidated balance sheet, being the amount of the capital stock included in items (a) and (c) in article 864.

(2) In respect of corporations affiliated by reason of ownership 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 con-

solidated return. In respect of each of the affiliated corporations the aggregate of the amounts ascertained under the provisions of paragraphs (4) and (5) shall in no case exceed 25 per cent of the outstanding capital stock of such corporation at the beginning of the taxable year.

ART. 866. Affiliated corporations: inadmissible assets.—Where adjustment is required in respect of inadmissible assets in accordance with the provisions of subdivision (c) of section 326 of the statute, such adjustment shall be made on the basis of the consolidated balance sheet with due regard to the adjustments and eliminations set forth in articles 864 and 865 and to the provisions of articles 815–818.

ART. 867. Affiliated corporations: stock of subsidiary acquired for cash.—When all or substantially all of the stock of a subsidiary corporation was acquired for cash, the cash so paid shall be the basis to be used in determining the value of the property acquired.

ART. 868. Affiliated corporations: stock of subsidiary acquired for stock.—Where stock of a subsidiary company was acquired with the stock of the parent company, the amount to be included in the consolidated invested capital in respect of the company acquired shall be computed in the same manner as if the net tangible assets and the intangible assets had been acquired instead of the stock. If in accordance with such acquisition a paid-in surplus is claimed, such claim shall be subject to the provisions of article 837.

ART. 869. Affiliated corporations: invested capital for prewar period.—The invested capital of affiliated corporations for the prewar period shall be computed on the same basis as the invested capital for the taxable year, except that where any one or more of the corporations included in the consolidation for the taxable year were in existence during the prewar period, but were not then affiliated as herein defined, then the average consolidated invested capital for the prewar period shall be the average invested capital of the corporations which were affiliated in the prewar period plus the aggregate of the average invested capital for each of the several corporations which were not affiliated during the prewar period. Full recognition, however, must be given to the provisions of section 330 of the statute, particularly the last paragraph thereof, and of articles 931–934.

ART. 870. Insurance companies.—The reserve funds of insurance companies, the net additions to which are deductible from gross income under the provisions of section 234 of the statute, cannot be included in computing invested capital. See sections 325 and 326(b) and articles 569 and 814.

ART. 871. Foreign corporations.—Inasmuch as the war profits and excess profits tax in the case of a foreign corporation is not based on the invested capital of the corporation, but is computed in accord-

ance with section 328 of the statute, the provisions of section 326 and of articles 831-870 have no application to foreign corporations. For the same reason, when rendering a return of income on form 1120 for a foreign corporation, no entry of invested capital should be made thereon. See article 962.

SPECIAL CASES.

SEC. 327. That in the following cases the tax shall be determined as provided in section 328:

(a) Where the Commissioner is unable to determine the invested capital as provided in section 326;

(b) In the case of a foreign corporation;

(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively;

(d) Where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profits upon a normal invested capital nor (2) in which 50 per centum or more of the gross income of the corporation for the taxable year (computed under section 233 of Title II) consists of gains, profits, commissions, or other income, derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

ART. 901. Treatment of special cases.—In the cases specified in section 327 of the statute the tax will be specially determined under the provisions of section 328, but the tax will not ordinarily be computed under section 328 merely because the corporation's form or manner of organization, or the limitations imposed by section 326, result in a greater tax than would otherwise be payable. A corporation which comes within the provisions of subdivision (d) of section 327 may make application for assessment under the provisions of section 328, which application shall be attached to its return in the form of a statement setting forth in full: (a) the reasons why the tax should be so determined; (b) the facts upon which such reasons are based; (c) an exact description of each trade or business or important branch of a trade or business carried on by it; (d) a statement of the invested capital and net income for each year since the beginning of the prewar period; and (e) a statement showing the amount of gains, profits, commissions or other income derived on a cost plus basis from Government contracts made after April 5, 1917, and before November 12, 1918, and

showing the per cent which such income is of the total income of the corporation. See sections 1 and 326 and articles 831-871 and 1510.

COMPUTATION OF TAX IN SPECIAL CASES.

SEC. 328. (a) In the cases specified in section 327 the tax shall be the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemption of \$3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business bears to their average net income (in excess of the specific exemption of \$3,000) for such year. In the case of a foreign corporation the tax shall be computed without deducting the specific exemption of \$3,000 either for the taxpayer or the representative corporations.

In computing the tax under this section the Commissioner shall compare the taxpayer only with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are, as nearly as may be, similarly circumstanced with respect to gross income, net income, profits per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

(b) For the purposes of subdivision (a) the ratios between the average tax and the average net income of representative corporations shall be determined by the Commissioner in accordance with regulations prescribed by him with the approval of the Secretary.

In cases in which the tax is to be computed under this section, if the tax as computed without the benefit of this section is less than 50 per centum of the net income of the taxpayer, the installments shall in the first instance be computed upon the basis of such tax; but if the tax so computed is 50 per centum or more of the net income, the installments shall in the first instance be computed upon the basis of a tax equal to 50 per centum of the net income. In any case, the actual ratio when ascertained shall be used in determining the correct amount of the tax. If the correct amount of the tax when determined exceeds 50 per centum of the net income, any excess of the correct installments over the amounts actually paid shall on notice and demand be paid together with interest at the rate of $\frac{1}{4}$ of 1 per centum per month on such excess from the time the installment was due.

(c) The Commissioner shall keep a record of all cases in which the tax is determined in the manner prescribed in subdivision (a), containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, and the amount of invested capital as determined under such subdivision. The Commissioner shall furnish a copy of such record and other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257.

ART. 911. Computation of tax in special cases.—In the cases specified in section 327 of the statute the tax is to be computed by comparison with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are engaged in a like or similar trade or business and similarly circumstanced. The provisions of section 328 do not permit the determination of a general average for any trade or business. In each case which comes under the provisions of section 327 the Commissioner will determine, as nearly as may be, the group or class of corporations with which the

corporation should be compared and the amount which bears the same ratio to the net income of the corporation (in excess of the specific exemption of \$3,000) for the taxable year as the average tax of such representative corporations bears to their average net income (in excess of the specific exemption of \$3,000) for such year. The comparison will take account of similarity with respect to gross income, net income, profit per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

ART. 912. Determination of first installment of tax in special cases.—In the case of any corporation, other than a foreign corporation, where absolutely no data are available for the determination of the invested capital for the taxable year, the installments of the tax shall in the first instance be determined upon the basis of a war profits and excess profits tax equal to 50% of the net income. In any other case under section 328 of the statute, other than the case of a foreign corporation, but including a case where the invested capital for the taxable year can not be accurately determined, but where a minimum amount of invested capital as to which there is no question can be determined, the installments shall in the first instance be determined upon the basis of a war profits and excess profits tax computed by using the minimum invested capital, such tax not to exceed an amount equal to 50% of the net income.

ART. 913. Determination of first installment of tax in the case of foreign corporation.—In the case of a foreign corporation the installments of the tax shall in the first instance be determined upon the basis of a war profits and excess profits tax computed by using its invested capital for the taxable year 1917, such tax not to exceed an amount equal to 50% of the net income. For the purpose of this article the invested capital for 1917 shall be adjusted for any subsequent changes in its amount due to cash or property paid in or withdrawn or to surplus or undivided profits of prior years retained in the business and properly attributable to its business within the United States. If the tax for 1917 was determined under section 210 of the Revenue Act of 1917, the constructive capital which would result in a tax equivalent to the tax determined under that section shall be used.

ART. 914. Payment of tax in special cases.—In any case falling under the last two articles the installments shall be paid upon the basis therein provided until the Commissioner notifies the corporation of the amount of tax computed under section 328. The installments shall then be recomputed upon the basis of a war profits and excess profits tax of such amount, and if the amount already paid is less than the amount which would have already become due if the installments had originally been computed upon that basis, the additional

amount shall be due and payable ten days after notice and demand from the collector. The provisions hereof supersede any inconsistent instructions in paragraph 10 of page 1 of instructions, or in paragraph 5 of page 2 of instructions, on return form 1120.

REORGANIZATIONS.

SEC. 330. That in the case of the reorganization, consolidation, or change of ownership after January 1, 1911, of a trade or business now carried on by a corporation, the corporation shall for the purposes of this title be deemed to have been in existence prior to that date, and the net income and invested capital of such predecessor trade or business for all or any part of the prewar period prior to the organization of the corporation now carrying on such trade or business shall be deemed to have been the net income and invested capital of such corporation.

If such predecessor trade or business was carried on by a partnership or individual the net income for the prewar period shall, under regulations prescribed by the Commissioner with the approval of the Secretary, be ascertained and returned as nearly as may be upon the same basis and in the same manner as provided for corporations in Title II, including a reasonable deduction for salary or compensation to each partner or the individual for personal services actually rendered.

In the case of the organization as a corporation before July 1, 1919, of any trade or business in which capital is a material income-producing factor and which was previously owned by a partnership or individual, the net income of such trade or business from January 1, 1918, to the date of such reorganization may at the option of the individual or partnership be taxed as the net income of a corporation is taxed under Titles II and III; in which event the net income and invested capital of such trade or business shall be computed as if such corporation had been in existence on and after January 1, 1918, and the undistributed profits or earnings of such trade or business shall not be subject to the surtax imposed in section 211, but amounts distributed on or after January 1, 1918, from the earnings of such trade or business shall be taxed to the recipients as dividends, and all the provisions of Titles II and III relating to corporations shall so far as practicable apply to such trade or business: *Provided*, That this paragraph shall not apply to any trade or business the net income of which for the taxable year 1918 was less than 20 per centum of its invested capital for such year: *Provided further*, That any taxpayer who takes advantage of this paragraph shall pay the tax imposed by section 1000 of this Act and by the first subdivision of section 407 of the Revenue Act of 1916, as if such taxpayer had been a corporation on and after January 1, 1918, with a capital stock having no par value.

If any asset of the trade or business in existence both during the taxable year and any prewar year is included in the invested capital for the taxable year but is not included in the invested capital for such prewar year, or is valued on a different basis in computing the invested capital for the taxable year and such prewar year, respectively, then under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary such readjustments shall be made as are necessary to place the computation of the invested capital for such prewar year on the basis employed in determining the invested capital for the taxable year.

ART. 931. Scope of reorganizations.—The first two paragraphs of section 330 of the statute relate only to the prewar period and not to the invested capital or net income for the taxable year. Under

their provisions in the case of a reorganization, consolidation or change of ownership, the corporation is regarded as having been in existence prior to the date of such reorganization, consolidation or change in ownership, and the net income and invested capital of the predecessor trade or business for all or any part of the prewar period prior to the organization of the present corporation are deemed to have been the net income and invested capital of such corporation.

ART. 932. Net income and invested capital of predecessor partnership or individual.—If the predecessor trade or business was carried on by a partnership or individual, the corporation shall make its return of the net income and invested capital of such trade or business as nearly as may be in the same manner as if such trade or business had been carried on by a corporation. It shall submit with its return a statement setting forth (a) the manner in which such trade or business was carried on and (b) the points, if any, in which the provisions of the statute and of the regulations are not fully applicable to the determination of the net income or invested capital of the predecessor trade or business for the prewar period. In no case shall the deduction from gross income for salary or compensation for personal services exceed the salaries or compensation customarily paid at that time by corporations or partnerships of similar size and standing engaged in similar trades or businesses for similar services under like responsibilities.

ART. 933. Election to be taxed as corporation.—A business enterprise (a) which is organized as a corporation before July 1, 1919, (b) in which capital is and has been a material income-producing factor, and (c) which was previously owned by a partnership or individual, may elect to be taxed as a corporation on its net income from January 1, 1918, to the date of organization of the corporation. In such event the corporation shall be treated as if in existence since January 1, 1918, for the purposes of the income tax, the war profits and excess profits tax, and the capital stock tax. The adoption of any other date than January 1, 1918, for such purpose is not permissible. But this option is not extended to a business enterprise with a net income for the taxable year 1918 less than 20 per cent of its invested capital.

ART. 934. Adjustment for asset differently valued in prewar invested capital.—In any case in which as a result of a reorganization or for any other reason any asset in existence both during the taxable year and any prewar year is included in computing the invested capital for the taxable year, but is not included in computing the invested capital for such prewar year, or is valued on a different basis in computing the invested capital for the two years, the difference resulting therefrom shall not be included in determining the difference 10 per cent of which is added to or deducted from the war profits credit

under section 311 (a) (2) of the statute. In any such case the corporation shall make the readjustment required by the statute, and shall submit with its return a full statement of the difference in such valuations and of the facts which give rise to such difference. See also section 331 and article 941.

VALUATION OF ASSETS UPON REORGANIZATION.

SEC. 331. In the case of the reorganization, consolidation, or change of ownership of a trade or business, or change of ownership of property, after March 3, 1917, if an interest or control in such trade or business or property of 50 per centum or more remains in the same persons, or any of them, then no asset transferred or received from the previous owner shall, for the purpose of determining invested capital, be allowed a greater value than would have been allowed under this title in computing the invested capital of such previous owner if such asset had not been so transferred or received: *Provided*, That if such previous owner was not a corporation, then the value of any asset so transferred or received shall be taken at its cost of acquisition (at the date when acquired by such previous owner) with proper allowance for depreciation, impairment, betterment or development, but no addition to the original cost shall be made for any charge or expenditure deducted as expense or otherwise on or after March 1, 1913, in computing the net income of such previous owner for purposes of taxation.

ART. 941. Valuation of asset upon change of ownership.—Where a business is reorganized, consolidated or transferred, or property is transferred, after March 3, 1917, and an interest of 50 per cent or greater in such business or property remains in any of the previous owners, then for the purpose of determining invested capital each asset so transferred is valued (a) as if still in the possession of the previous owner, if a corporation, or, if not a corporation, (b) at its cost to such previous owner, with proper adjustments for losses and improvements. This provision is accordingly concerned with the computation of invested capital for the taxable year, while section 330 of the statute is chiefly concerned with the determination of invested capital for the prewar period. See articles 931, 932 and 1561-1570.

FISCAL YEARS ENDING IN 1918 OR 1919.

SEC. 335. (a) That if a corporation (other than a personal service corporation) makes return for a fiscal year beginning in 1917 and ending in 1918, the tax for the first taxable year under this title shall be the sum of: (1) the same proportion of a tax for the entire period computed under Title II of the Revenue Act of 1917 which the portion of such period falling within the calendar year 1917 is of the entire period, and (2) the same proportion of a tax for the entire period computed under this title at the rates specified in subdivision (a) of section 301 which the portion of such period falling within the calendar year 1918 is of the entire period.

Any amount heretofore or hereafter paid on account of the tax imposed for such fiscal year by Title II of the Revenue Act of 1917 shall be credited toward the payment of the tax imposed for such fiscal year by this title, and if the amount so paid exceeds the amount of the tax imposed by this title the

excess shall be credited or refunded to the corporation in accordance with the provisions of section 252.

(b) If a corporation makes return for a fiscal year beginning in 1918 and ending in 1919, the tax for such fiscal year under this title shall be the sum of: (1) the same proportion of a tax for the entire period computed under subdivision (a) of section 301 which the portion of such period falling within the calendar year 1918 is of the entire period, and (2) the same proportion of a tax for the entire period computed under subdivision (b) or (c) of section 301 which the portion of such period falling within the calendar year 1919 is of the entire period.

(c) If a partnership or a personal service corporation makes return for a fiscal year beginning in 1917 and ending in 1918, it shall pay the same proportion of a tax for the entire period computed under Title II of the Revenue Act of 1917 which the portion of such period falling within the calendar year 1917 is of the entire period.

Any tax paid by a partnership or personal service corporation for any period beginning on or after January 1, 1918, shall be immediately refunded to the partnership or corporation as a tax erroneously or illegally collected.

ART. 951. Fiscal year with different rates.—Section 335 of the statute applies to the war profits and excess profits tax. For provisions with respect to the income tax see section 205 of the statute and articles 1621–1625. Subdivision (a), which deals with fiscal years beginning in 1917 and ending in 1918, and subdivision (b), which deals with fiscal years beginning in 1918 and ending in 1919, apply to corporations other than personal service corporations. Subdivision (c), which deals with fiscal years beginning in 1917 and ending in 1918, applies to partnerships and to personal service corporations. See as to partnerships articles 321–327 and as to personal service corporations articles 328–335. See also section 252 of the statute and articles 1034–1036. Partnerships and personal service corporations having fiscal years beginning in 1918 and ending in 1919 are not subject to the war profits and excess profits tax.

ART. 952. Fiscal year of corporation ending in 1918.—The method provided for computing the tax for a fiscal year beginning in 1917 and ending in 1918 is as follows: (a) the tax attributable to the calendar year 1917 is found by computing the income of the taxpayer and the tax thereon in accordance with Title II of the Revenue Act of 1917 as if the fiscal year was the calendar year 1917, and determining the proportion of such tax which the number of months falling within the calendar year 1917 is of the number of months in the entire period; (b) the tax attributable to the calendar year 1918 is found by computing the income of the taxpayer and the tax thereon in accordance with the present statute as if the fiscal year was the calendar year 1918, and determining the proportion of such tax which the number of months falling within the calendar year is of the number of months in the entire period; and (c) the tax for the fiscal year is found by adding the tax attributable to the calendar year 1917 and the tax attributable to the calendar year 1918.

ART. 953. Deductions and credits in the case of fiscal year ending in 1918.—Net losses deductible from net income of the fiscal year under the provisions of section 204 of the statute shall be deductible in computing the tax attributable to the calendar year 1917 as well as in computing the tax attributable to the calendar year 1918. See articles 1601–1603. Amounts previously paid by the taxpayer on account of the excess profits tax for its fiscal year ending in 1918 shall be credited towards the payment of the war profits and excess profits tax imposed for such fiscal year by the present statute. Any excess shall be credited or refunded in accordance with the provisions of section 252 of the statute. For credits for foreign taxes see section 238 of the statute and article 611.

ART. 954. Fiscal year of corporation ending in 1919.—The method provided for computing the tax for a fiscal year beginning in 1918 and ending in 1919 is as follows: (a) the tax attributable to the calendar year 1918 is found by computing the income of the taxpayer and the tax thereon in accordance with the statute as if the fiscal year was the calendar year 1918, and determining the proportion of such tax which the number of months falling within the calendar year 1918 is of the number of months in the entire period; (b) the tax attributable to the calendar year 1919 is found by computing the income of the taxpayer and the tax thereon in accordance with the statute as if the fiscal year was the calendar year 1919, and determining the proportion of such tax which the number of months falling within the calendar year 1919 is of the number of months in the entire period; and (c) the tax for the fiscal year is found by adding the tax attributable to the calendar year 1918 and the tax attributable to the calendar year 1919. For credits for foreign taxes see section 238 of the statute and article 611.

ART. 955. Illustration of computation of tax for fiscal year.—

A corporation makes its return on the basis of a fiscal year ending March 31. It had an average prewar invested capital of \$50,000 and an average prewar net income of \$3,500. For the fiscal year ending March 31, 1918, its invested capital and net income are \$100,000 and \$75,000, respectively, as computed under Title II of the Revenue Act of 1917, and \$125,000 and \$70,000, respectively, as computed under the present statute. Such a difference in these amounts as computed under the two acts may readily occur where, for example, a corporation is allowed under the present statute a deduction for interest, amortization, etc., which it was not allowed under the Revenue Act of 1917, or where, under the present statute, it is allowed a greater amount of invested capital on account of intangible property paid in for stock or shares than allowed under the Revenue Act of 1917. For the fiscal year ending March 31, 1919, its invested capital and net income are \$125,000 and \$60,000, respectively.

(1) A war excess profits tax for the year ending March 31, 1918, as computed under the provisions of Title II of the Revenue Act of 1917, and upon the basis of an invested capital of \$100,000 and a net income of \$75,000 as computed under that Act, is \$32,800. For the details of this computation see illustration (1) under article 16 of Regulations 41. A war profits and excess profits tax for the entire period as computed under subdivision (a) of section 301 of the present statute, and upon the basis of an

invested capital of \$125,000 and a net income of \$70,000 as computed under the statute, is \$43,600. Section 335 provides that the tax for this period is the sum of $\frac{9}{12}$ of the tax of \$32,800 as computed under the Revenue Act of 1917, or \$24,600, plus $\frac{3}{12}$ of the tax of \$43,600 as computed under the present statute, or \$10,900, making a total war excess profits tax for the fiscal year ending March 31, 1918, of \$35,500.

(2) A war profits and excess profits tax for the year ending March 31, 1919, as computed under subdivision (a) of section 301 of the statute is \$35,600. A war profits and excess profits tax for the entire period as computed under subdivision (b) of section 301 is \$16,400. Section 335 provides that the tax for this period is the sum of $\frac{9}{12}$ of the tax of \$35,600, as computed under subdivision (a) of section 301, or \$26,700, plus $\frac{3}{12}$ of the tax of \$16,400, as computed under subdivision (b) of section 301, or \$4,100, making a total war profits and excess profits tax for the fiscal year ending March 31, 1919, of \$30,800.

RETURNS.

SEC. 336. That every corporation, not exempt under section 304, shall make a return for the purposes of this title. Such returns shall be made, and the taxes imposed by this title shall be paid, at the same times and places, in the same manner, and subject to the same conditions, as is provided in the case of returns and payment of income tax by corporations for the purposes of Title II, and all the provisions of that title not inapplicable, including penalties, are hereby made applicable to the taxes imposed by this title.

ART. 961. Returns.—Every corporation, domestic or foreign, not exempt under section 304 of the statute and article 751, shall make a return for the purpose of the war profits and excess profits tax on form 1120. The return shall be made and the tax shall be paid as provided in the case of a return for and payment of the income tax by corporations. See generally Parts II A and III of the regulations, and particularly sections 239, 240, 241, 250 and 253 of the statute and the articles thereunder.

ART. 962. Returns in special cases.—Where a corporation computes its war profits credit upon the basis of the sum of (a) the specific exemption and (b) an amount equal to 10 per cent of the invested capital for the taxable year, the items on form 1120 which relate solely to the net income or to the invested capital for the prewar period need not be filled in. Where a corporation enters on its return a war profits and excess profits tax equal to the amount of the maximum tax determined under section 302 of the statute, the items on form 1120 which relate solely to the net income for the prewar period and the items which relate to the invested capital for the prewar period and for the taxable year need not be filled in. Likewise in the case of a foreign corporation the same items may be disregarded, except that all of schedule I on form 1120 shall be filled in and balance sheets as of the beginning and the end of the taxable year for the entire business of the corporation both within and without the United States shall be submitted. See article 871. The Commissioner may at any time specifically call for

all or any part of the information which under this article is not required to be entered on the return. In any case, however, where a claim is made under sections 327 and 328 of the statute, other than in the case of a foreign corporation, the corporation should fill out all items of the return so far as possible and submit a statement explaining why it is impracticable to fill out the entire return.

SALE OF MINERAL DEPOSITS.

SEC. 337. That in the case of a bona fide sale of mines, oil or gas wells, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, the portion of the tax imposed by this title attributable to such sale shall not exceed 20 per centum of the selling price of such property or interest.

ART. 971. Tax on sale of mineral deposits.—In the case of a sale of mines, oil or gas wells, or any interest therein, as described in article 13, the portion of the war profits and excess profits tax attributable to such a sale shall not exceed 20 per cent of the selling price. To determine the application of this provision to a particular case the corporation should compute the war profits and excess profits tax in the ordinary way upon its net income, including its net income from any such sale. The proportion of the total tax indicated by the ratio which the taxpayer's net income from the sale of the property, computed as prescribed in article 715, bears to its total net income is the portion of the tax attributable to such sale, and if it exceeds 20 per cent of the selling price of the property such portion of the tax shall be reduced to that amount. See articles 219, 220 and 221.

ART. 972. Illustration of computation of tax where sale of mineral deposits.—

In the case of the corporation used as an illustration in article 716, let it be assumed that its gross income for 1918 included \$15,000 derived from a bona fide sale of an oil well, the principal value of which had been demonstrated by exploration and discovery work done by the corporation, and that the Commissioner finds under article 715 that only \$800 of the deductions allowed are properly applicable to the gross income derived from the sale. The portion of the net income attributable to the sale would be \$14,200, which is 35.5 per cent of the entire net income of \$40,000, and the portion of the tax for that year attributable to the sale will be 35.5 per cent of the entire tax of \$17,600, or \$6,248. But this portion of the tax can not exceed 20 per cent of the selling price (\$15,000) and is accordingly reduced to \$3,000. The total tax will be \$11,352 (the portion of the tax not affected) plus \$3,000, or \$14,352 (instead of \$17,600).

PART III.

ADMINISTRATIVE PROVISIONS.

PAYMENT OF TAXES.

Sec. 250. (a) That except as otherwise provided in this section and sections 221 and 237 the tax shall be paid in four installments, each consisting of one-fourth of the total amount of the tax. The first installment shall be paid at the time fixed by law for filing the return, and the second installment shall be paid on the fifteenth day of the third month, the third installment on the fifteenth day of the sixth month, and the fourth installment on the fifteenth day of the ninth month, after the time fixed by law for filing the return. Where an extension of time for filing a return is granted the time for payment of the first installment shall be postponed until the date of the expiration of the period of the extension, but the time for payment of the other installments shall not be postponed unless the Commissioner so provides in granting the extension. In any case in which the time for the payment of any installment is at the request of the taxpayer thus postponed, there shall be added as part of such installment interest thereon at the rate of $\frac{1}{4}$ of 1 per centum per month from the time it would have been due if no extension had been granted, until paid. If any installment is not paid when due, the whole amount of the tax unpaid shall become due and payable upon notice and demand by the collector.

The tax may at the option of the taxpayer be paid in a single payment instead of in installments, in which case the total amount shall be paid on or before the time fixed by law for filing the return, or, where an extension of time for filing the return has been granted, on or before the expiration of the period of such extension.

(b) As soon as practicable after the return is filed, the Commissioner shall examine it. If it then appears that the correct amount of the tax is greater or less than that shown in the return, the installments shall be recomputed. If the amount already paid exceeds that which should have been paid on the basis of the installments as recomputed, the excess so paid shall be credited against the subsequent installments; and if the amount already paid exceeds the correct amount of the tax, the excess shall be credited or refunded to the taxpayer in accordance with the provisions of section 252.

If the amount already paid is less than that which should have been paid, the difference shall, to the extent not covered by any credits then due to the taxpayer under section 252, be paid upon notice and demand by the collector. In such case if the return is made in good faith and the understatement of the amount in the return is not due to any fault of the taxpayer, there shall be no penalty because of such understate-

ment. If the understatement is due to negligence on the part of the taxpayer, but without intent to defraud, there shall be added as part of the tax 5 per centum of the total amount of the deficiency, plus interest at the rate of 1 per centum per month on the amount of the deficiency of each installment from the time the installment was due. If the understatement is false or fraudulent with intent to evade the tax, then, in lieu of the penalty provided by section 3176 of the Revised Statutes, as amended, for false or fraudulent returns wilfully made, but in addition to other penalties provided by law for false or fraudulent returns, there shall be added as part of the tax 50 per centum of the amount of the deficiency.

(c) If the return is made pursuant to section 3176 of the Revised Statutes as amended, the amount of tax determined to be due under such return shall be paid upon notice and demand by the collector.

(d) Except in the case of false or fraudulent returns with intent to evade the tax, the amount of tax due under any return shall be determined and assessed by the Commissioner within five years after the return was due or was made, and no suit or proceeding for the collection of any tax shall be begun after the expiration of five years after the date when the return was due or was made. In the case of such false or fraudulent returns, the amount of tax due may be determined at any time after the return is filed, and the tax may be collected at any time after it becomes due.

(e) If any tax remains unpaid after the date when it is due, and for ten days after notice and demand by the collector, then, except in the case of estates of insane, deceased, or insolvent persons, there shall be added as part of the tax the sum of 5 per centum on the amount due but unpaid, plus interest at the rate of 1 per centum per month upon such amount from the time it became due: *Provided*, That as to any such amount which is the subject of a bona fide claim for abatement such sum of 5 per centum shall not be added and the interest from the time the amount was due until the claim is decided shall be at the rate of $\frac{1}{3}$ of 1 per centum per month.

In the case of the first installment provided for in subdivision (a) the instructions printed on the return shall be deemed sufficient notice of the date when the tax is due and sufficient demand, and the taxpayer's computation of the tax on the return shall be deemed sufficient notice of the amount due.

(f) In any case in which in order to enforce payment of a tax it is necessary for a collector to cause a warrant of distraint to be served, there shall also be added as part of the tax the sum of \$5.

(g) If the Commissioner finds that a taxpayer designs quickly to depart from the United States or to remove his property therefrom, or to conceal himself or his property therein, or to do any other act tending to prejudice or to render wholly or partly ineffectual proceedings to collect the tax for the taxable year then last past or the taxable year then current unless such proceedings be brought without delay, the Commissioner shall declare the taxable period for such taxpayer terminated at the end of the calendar month then last past and shall cause notice of such finding and declaration to be given the taxpayer, together with a demand for immediate payment of the tax for the taxable period so declared terminated and of the tax for the preceding taxable year or so much of said tax as is unpaid, whether or not the

time otherwise allowed by law for filing return and paying the tax has expired; and such taxes shall thereupon become immediately due and payable. In any action or suit brought to enforce payment of taxes made due and payable by virtue of the provisions of this subdivision the finding of the Commissioner, made as herein provided, whether made after notice to the taxpayer or not, shall be for all purposes presumptive evidence of the taxpayer's design. A taxpayer who is not in default in making any return or paying income, war-profits, or excess-profits tax under any Act of Congress may furnish to the United States, under regulations to be prescribed by the Commissioner with the approval of the Secretary, security approved by the Commissioner that he will duly make the return next thereafter required to be filed and pay the tax next thereafter required to be paid. The Commissioner may approve and accept in like manner security for return and payment of taxes made due and payable by virtue of the provisions of this subdivision, provided the taxpayer has paid in full all other income, war-profits, or excess-profits taxes due from him under any Act of Congress. If security is approved and accepted pursuant to the provisions of this subdivision and such further or other security with respect to the tax or taxes covered thereby is given as the Commissioner shall from time to time find necessary and require, payment of such taxes shall not be enforced by any proceedings under the provisions of this subdivision prior to the expiration of the time otherwise allowed for paying such respective taxes.

ART. 1001. Time for payment of tax.—The tax, unless paid at the source, is to be paid to the collector in four equal installments, the first at the time for filing the return and the others at intervals of three months thereafter, or it may at the option of the taxpayer be paid in a single payment on or before the time for filing the return for such time as extended. See section 227 of the statute and articles 441-447. An unconditional extension of time for filing a return will postpone the date for payment of the first installment, but will not postpone the date of payment of the other installments unless so specified in each case. Upon failure to pay an installment on time, all of the tax remaining unpaid becomes due and payable upon notice and demand. Upon recomputation of the tax, if the amount already paid exceeds the correct amount of the installment or of the whole tax, the excess shall be credited against subsequent installments or other similar taxes then due from the taxpayer or, if there is no such installment or tax, shall be refunded to him; but if the amount already paid is less than the correct amount of the installment or tax then due, the difference shall be paid upon notice and demand with interest. See section 252 and articles 1034-1036.

ART. 1002. Payment of tax when no proper return.—Section 3176 of the Revised Statutes, as amended by section 1317 of the Revenue Act of 1918, provides:

Sec. 3176. If any person, corporation, company or association fails to make and file a return or list at the time prescribed by law or by

regulation made under authority of law, or makes, willfully or otherwise, a false or fraudulent return or list, the collector or deputy collector shall make the return or list from his own knowledge and from such information as he can obtain through testimony or otherwise. In any such case the Commissioner may, from his own knowledge and from such information as he can obtain through testimony or otherwise, make a return or amend any return made by a collector or deputy collector. Any return or list so made and subscribed by the Commissioner, or by a collector or deputy collector and approved by the Commissioner, shall be prima facie good and sufficient for all legal purposes.

If the failure to file a return or list is due to sickness or absence, the collector may allow such further time, not exceeding thirty days, for making and filing the return or list as he deems proper.

The Commissioner of Internal Revenue shall determine and assess all taxes, other than stamp taxes, as to which returns or lists are so made under the provisions of this section. In case of any failure to make and file a return or list within the time prescribed by law, or prescribed by the Commissioner of Internal Revenue or the collector in pursuance of law, the Commissioner of Internal Revenue shall add to the tax 25 per centum of its amount, except that when a return is filed after such time and it is shown that the failure to file it was due to a reasonable cause and not to willful neglect, no such addition shall be made to the tax. In case a false or fraudulent return or list is willfully made, the Commissioner of Internal Revenue shall add to the tax 50 per centum of its amount.

The amount so added to any tax shall be collected at the same time and in the same manner and as part of the tax unless the tax has been paid before the discovery of the neglect, falsity, or fraud, in which case the amount so added shall be collected in the same manner as the tax.

Accordingly, if a return is not made on time or is false, and the collector or Commissioner makes a return, the amount of tax determined to be due under such substitute return shall be paid in full upon notice and demand by the collector. See further articles 443-446, 1004 and 1005.

ART. 1003. Interest on tax.—Where the time for the payment of any installment of the tax is postponed at the request of the taxpayer, interest at the rate of 6 per cent per annum is added from the original due date. If an understatement of the tax in the return is due to the negligence of the taxpayer, but without intent to defraud, interest at the rate of 12 per cent per annum is added to the amount of the deficiency of each installment from the time the installment was due. If any tax remains due and unpaid for ten days after notice and demand by the collector, or in the case of the first installment as computed by the taxpayer remains due and unpaid for ten days, interest at the rate of 12 per cent per annum is added from the due date, except that the interest on any amount which is the subject of a bona fide claim for abatement shall be at the rate of 6 per

cent per annum, and except that no interest is added in the case of estates of insane, deceased or insolvent persons. But if any part of a claim for abatement on the ground of a loss in inventory under section 214(a) (12) or section 234(a) (14) of the statute is disallowed, interest from the original due date at the rate of 12 per cent per annum will be added to the tax not abated; and interest is to be added in all cases in which the demand of payment is made of the taxpayer personally, although he subsequently dies, or becomes insane or insolvent, so that collection of the tax is made from his estate in the hands of his representative. See further articles 1005 and 1006.

ART. 1004. Penalty for failure to file return.—In case of failure to make a return on time, a penalty of 25 per cent of the amount of the tax is added to it, unless the return is later filed and the failure to file it is satisfactorily shown to be due to a reasonable cause. See article 1002. Two classes of delinquents are liable to the penalty: (*a*) those who do not file returns and for whom returns are made by the collector or Commissioner; and (*b*) those who file tardy returns and are unable to show reasonable cause for the delay. Taxpayers wishing to avoid the penalty must make an affirmative showing of the facts alleged as a reasonable cause for failure to make a return on time in the form of an affidavit under oath, which should be attached to the return. If such an explanation is furnished with the return or upon the collector's demand, the collector, unless otherwise directed by the Commissioner, will forward the affidavit with the return, and if the Commissioner determines that the delinquency was due to a reasonable cause the 25 per cent penalty will not be assessed. "Reasonable cause" is such a condition of fact that had the taxpayer in default exercised ordinary business care and prudence it would have been impracticable or impossible for him to file a return in the prescribed time. See also section 253 of the statute and article 1041.

ART. 1005. Penalty for understated return.—(*a*) If an understatement of the amount of the tax in a return of income is due to negligence on the part of the taxpayer, but without intent to defraud, a penalty of 5 per cent of the amount of the deficiency is added; but (*b*) if the understatement of the tax is false with intent to evade the tax, a penalty of 50 per cent of the amount of the deficiency is added. (*c*) In case a false or fraudulent return is willfully made, other than as specified in (*b*) above, a penalty of 50 per cent of the amount of the tax is added. See articles 1002 and 1003. In general, negligence is attributable to the taxpayer if he computes the tax in disregard of the instructions on the return form or otherwise incorrectly, unless he can show that his error was due to an honest misunderstanding of the facts or the law of which an average reasonable man might be capable. See also section 253 of the statute and article 1041.

ART. 1006. Penalty for nonpayment of tax.—If any tax or installment thereof remains due and unpaid for ten days after notice and demand by the collector (the instructions on the return serve as notice and demand in the case of the first installment as computed by the taxpayer), a penalty of 5 per cent is added. When, however, upon an assessment of a tax and demand made for payment, a bona fide claim for its abatement is filed within 10 days after such demand, no penalty is imposed. Upon receipt of a notice of rejection of the claim (or so much thereof as is not allowed), the collector will notify the claimant and demand the payment of the tax. If the tax is not then paid within 10 days, the 5 per cent penalty will be assessed on the amount of tax not abated. If abatement of the entire tax assessed is not demanded in a claim, and the balance of the tax is not paid within the required 10 days, the 5 per cent penalty will immediately accrue on such balance. See also article 1003. The estate of a deceased person, regardless of the date of his death, or of an insane or insolvent person, cannot be charged with liability to the 5 per cent penalty on account of his or the fiduciary's delinquency in making payment of taxes. Where a warrant of distraint is served, \$5 is added. For other penalties see section 253 of the statute and article 1041.

ART. 1007. Notice and demand of payment.—The service of a notice and demand by the collector on form 17 is complete upon mailing it, and the time within which the tax must be paid runs from the date of mailing the notice and not of its receipt by the taxpayer. But payment for the tax must actually reach the collector within the ten day period, and merely mailing a remittance before the expiration of the ten days is not sufficient. So, to avoid the prescribed penalties, no more than ten days may elapse after the mailing of the notice before the payment is in the collector's hands. See section 3184 of the Revised Statutes. By reason, however, of absence from their homes or places of business in foreign countries or in the military or other service of the country and the consequent delay in receiving mail, or by reason of the location of the residence of an individual or of the office of a corporation to which the notice was addressed at a distance from the collector's office, it is impossible for many persons to receive a notice and demand and to make payment of the tax so that such payment may be received by the collector within the ten day period following the service of notice and demand, and in all such cases the collector will enter on the notice as the date on which the tax becomes due and payable a date as nearly as possible ten days after the time that the notice should be received in the ordinary course of the mails by the taxpayer. In such cases when it appears that a remittance for the tax was placed in the mails within

the ten day period after the date specified in the notice, and in cases where tardiness is occasioned because the notice was not delivered in due time by reason of delay in the mail and satisfactory evidence of that fact is furnished, the penalty and interest will not be collected.

ART. 1008. Collection of tax by suit.—Taxes, fines, penalties and forfeitures may be sued for and recovered in the name of the United States in the district courts of the United States. Suits for the collection of taxes may be brought at any time within five years after the return was due or was made, whether the taxes have been assessed, or are assessable, or not. In the case of false or fraudulent returns with intent to evade the tax no statute of limitations runs against the Government. Section 3164 of the Revised Statutes, as amended by section 1317 of the Revenue Act of 1918, provides:

SEC. 3164. It shall be the duty of every collector of internal revenue having knowledge of any willful violation of any law of the United States relating to the revenue, within thirty days after coming into possession of such knowledge, to file with the district attorney of the district in which any fine, penalty, or forfeiture may be incurred, a statement of all the facts and circumstances of the case within his knowledge, together with the names of the witnesses, setting forth the provisions of law believed to be so violated on which reliance may be had for condemnation or conviction.

However, no suit for the recovery of unpaid taxes or of any fine, penalty or forfeiture shall be commenced until the collector shall have submitted to the Commissioner a full report of all material facts and circumstances in the case and shall have received from him express authority to proceed. See sections 3212–3216 of the Revised Statutes, and also Regulations No. 2 (revised) and Regulations No. 12 (revised).

ART. 1009. Collection of tax by distraint.—If any person liable to pay any taxes neglects or refuses to pay them within ten days after notice and demand, it shall be lawful for the collector or his deputy to collect such taxes with 5 per cent additional and interest at 12 per cent per annum by distraint and sale of the goods, chattels or effects, including stocks, securities and evidences of debt, of the person delinquent. When goods, chattels or effects sufficient to satisfy the taxes imposed upon any person are not found by the collector or deputy collector, he is authorized to collect such taxes by seizure and sale of real estate. See further sections 3186 (as amended by the Act of March 4, 1913), 3187–3196, 3197 (as amended by the Act of March 1, 1879), 3198–3202, 3203 (as amended by the Act of March 1, 1879), 3204–3207, 3208 (as amended by the Act of March 1, 1879) and 3209 of the Revised Statutes and Regulations No. 12 (revised). Distraint may also be used against a delinquent collector. See section 3217 of the Revised Statutes.

ART. 1010. Enforcement of tax lien by bill in equity.—In any case where there has been failure to pay the tax and it has become necessary to seize and sell real estate to satisfy it, a bill in equity may be filed in a district court of the United States to enforce the lien of the United States for tax upon any real estate in which the delinquent has any right, title or interest. This remedy does not supersede distraint, but is cumulative. In the event of nonpayment of a tax after demand it becomes a lien in favor of the United States from the time when the assessment list was received by the collector upon all property and rights to property belonging to the taxpayer, except that the lien is not valid as against any mortgagee, purchaser or judgment creditor until notice thereof is filed in the proper public office or offices on form 668. See sections 3186 (as amended by the Act of March 4, 1913) and 3207 of the Revised Statutes and Regulations No. 12 (revised).

ART. 1011. Compromise of tax cases.—The Commissioner, with the advice and consent of the Secretary of the Treasury, may compromise any civil or criminal case arising under the internal revenue laws instead of commencing suit thereon, and with the advice and consent of the Secretary and the recommendation of the Attorney-General may compromise any such case after suit thereon has been commenced by the United States. Accordingly, the power to compromise extends to (a) both civil and criminal cases; (b) cases whether before or after suit; and (c) both taxes and penalties. Refunds can not be made of accepted offers in compromise in cases where it is subsequently ascertained that no violation of law was involved. See further sections 3229 and 3469, and sections 5292 and 5293 (as amended by the Act of February 27, 1877), of the Revised Statutes.

ART. 1012. Assessment of tax.—When the returns are received at the collectors' offices, they are examined and listed before being forwarded to the Commissioner. If it appears that the tax is greater or less than shown in the return, it is recomputed. After checking the figures the Commissioner assesses the tax on the basis of the collectors' lists. The collectors then send out bills for the taxes, either as computed by the taxpayer or as recomputed. If a taxpayer believes that he has been overassessed, he may file a claim for abatement or (after payment of the tax) for a refund of the excess. See section 252 of the statute and articles 1031–1038. As soon as practicable the returns are carefully audited by accountants in the office of the Commissioner at Washington, assisted where necessary by reports of the examination of taxpayers' books and records made by revenue agents in the field. If error in a return is detected, the taxpayer is notified accordingly and an additional assessment is made against him or he is given the opportunity to file a claim for a re-

fund, as the case may be. Any assessment must be made within five years after the return was due or was made, except in the case of false returns with intent to evade the tax. See sections 228, 1305 and 1318 of the statute and articles 451 and 1711.

ART. 1013. Declaration of termination of taxable period.—In the case of a taxable person who designs by immediate departure from the country or otherwise to avoid payment of the tax for the preceding or current taxable year, the Commissioner may so find upon evidence satisfactory to him and may declare the taxable period for such person terminated at the end of the month last past, causing the service upon him of a notice and demand for immediate payment of the tax declared due and any other tax unpaid. In such a case the taxpayer is entitled to a full personal exemption and credit for dependents. See section 216 of the statute and article 305. If suit is necessary to collect the tax, the Commissioner's finding is presumptive evidence of the taxpayer's design. A person who is not in default in making returns or in paying other taxes may procure the postponement until the usual time of the payment of taxes declared or declarable to be due pursuant to this article by depositing with the Commissioner United States bonds of a principal amount double the estimated amount of taxes due from such person for the taxable year or by furnishing such other security as may be approved by the Commissioner. See section 1320.

RECEIPTS FOR TAXES.

SEC. 251. That every collector to whom any payment of any tax is made under the provisions of this title shall upon request give to the person making such payment a full written or printed receipt, stating the amount paid and the particular account for which such payment was made; and whenever any debtor pays taxes on account of payments made or to be made by him to separate creditors the collector shall, if requested by such debtor, give a separate receipt for the tax paid on account of each creditor in such form that the debtor can conveniently produce such receipts separately to his several creditors in satisfaction of their respective demands up to the amounts stated in the receipts; and such receipt shall be sufficient evidence in favor of such debtor to justify him in withholding from his next payment to his creditor the amount therein stated; but the creditor may, upon giving to his debtor a full written receipt acknowledging the payment to him of any sum actually paid and accepting the amount of tax paid as aforesaid (specifying the same) as a further satisfaction of the debt to that amount, require the surrender to him of such collector's receipt.

ART. 1021. Receipts for tax payments.—Upon request a collector will give a receipt for each tax payment. In the case of payments made by check or money order the cancelled check or the money order receipt is usually a sufficient receipt. In the case of payments in cash, however, the taxpayer should in every instance require and the collector should furnish a receipt.

REFUNDS.

SEC. 252. That if, upon examination of any return of income made pursuant to this Act, the Act of August 5, 1909, entitled "An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," the Act of October 3, 1913, entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," the Revenue Act of 1916, as amended, or the Revenue Act of 1917, it appears that an amount of income, war-profits or excess-profits tax has been paid in excess of that properly due, then, notwithstanding the provisions of section 3228 of the Revised Statutes, the amount of the excess shall be credited against any income, war-profits or excess-profits taxes, or installment thereof, then due from the taxpayer under any other return, and any balance of such excess shall be immediately refunded to the taxpayer: *Provided*, That no such credit or refund shall be allowed or made after five years from the date when the return was due, unless before the expiration of such five years a claim therefor is filed by the taxpayer.

ART. 1031. Authority for abatement, credit and refund of taxes.—Authority for the credit, refund or abatement of taxes erroneously collected or assessed is contained in section 252 of the statute and in section 3220 of the Revised Statutes, as amended by section 1316 of the Revenue Act of 1918, which provides:

SEC. 3220. The Commissioner of Internal Revenue, subject to regulations prescribed by the Secretary of the Treasury, is authorized to remit, refund, and pay back all taxes erroneously or illegally assessed or collected, all penalties collected without authority, and all taxes that appear to be unjustly assessed or excessive in amount, or in any manner wrongfully collected; also to repay to any collector or deputy collector the full amount of such sums of money as may be recovered against him in any court, for any internal revenue taxes collected by him, with the cost and expenses of suit; also all damages and costs recovered against any assessor, assistant assessor, collector, deputy collector, agent, or inspector, in any suit brought against him by reason of anything done in the due performance of his official duty, and shall make report to Congress at the beginning of each regular session of Congress of all transactions under this section.

Section 3225 of the Revised Statutes, as amended by section 1316 of the Revenue Act of 1918, however, provides:

SEC. 3225. When a second assessment is made in case of any list, statement or return, which in the opinion of the collector or deputy collector was false or fraudulent, or contained any understatement or undervaluation, such assessment shall not be remitted, nor shall taxes collected under such assessment be refunded, or paid back, or recovered by any suit, unless it is proved that such list, statement, or return was not willfully false or fraudulent and did not contain any willful understatement or undervaluation.

Authority for the abatement of uncollectible taxes due from persons absconded or insolvent is contained in section 3218 of the Revised Statutes. These provisions apply to the income and war profits and

excess profits taxes imposed by the present statute and also to the excise tax under the Act of 1909, the income tax under the Acts of 1913 and 1916, and the income and excess profits taxes under the Act of 1917.

ART. 1032. Claims for abatement of taxes erroneously assessed.—Claims by the taxpayer for the abatement of taxes or penalties erroneously or illegally assessed or abatable under remedial acts shall be made on form 47. They must be sustained by the affidavits of the parties against whom the taxes were assessed, or of other parties cognizant of the facts. When a tax has been assessed and turned over to the collector, the presumption is that the assessment is correct. The burden of proof in rebutting the presumption and showing that it was improperly or illegally assessed, or that relief should be given under a remedial statute, rests upon the applicant for abatement. The affidavits must therefore contain full and explicit statements of all the material facts relating to the claim in support of which they are offered and to the proper consideration of which they are essential. The legality of the claim is to be determined by the Commissioner upon the facts presented by the affidavits. The filing of a claim for abatement does not necessarily operate as a suspension of the collection of the tax or make it any less the duty of the collector to exercise due diligence to prevent the collection of the tax being jeopardized. He should, if he considers it necessary, collect the tax and leave the taxpayer to his remedy by a claim for refund. See further Regulations No. 14 (revised). A collector may himself present once a month a blanket claim on form 47 for the abatement of taxes coming within certain classes of taxes erroneously assessed.

ART. 1033. Claims for abatement of uncollectible taxes.—When a tax is found to be uncollectible, the collector or deputy collector who made the demand for payment and is conversant with the facts may prepare a claim for abatement on form 53. See Regulations No. 14 (revised). Although credits allowed on account of insolvency or absconding release the collector from the obligation created by his receipt for the amount credited, the obligation to pay still remains upon the person assessed. It is the duty of the collector to use the same diligence to collect a tax after it has been abated as uncollectible as before abatement. Collectors should therefore keep a record of all taxes thus credited and of the persons from whom they are due, and should enforce payment whenever it is in their power to do so.

ART. 1034. Claims for credit of taxes erroneously collected.—Any amount of income, war profits or excess profits tax paid in excess of that properly due shall be credited against any such taxes due from the taxpayer under any other return. To obtain such credit the taxpayer should proceed as follows:

(1) Where the credit demanded is equal to or less than any outstanding assessment of tax, a taxpayer desiring to obtain such credit shall file with the collector for the district in which his original return was filed a claim on form 47 A, which shall be sworn to and shall contain the following statements: (*a*) business engaged in by claimant; (*b*) character of assessment; (*c*) amount of tax paid and for what taxable year; (*d*) portion of tax under (*c*) claimed as a credit; (*e*) unpaid assessment against which credit is asked and for what taxable year; and (*f*) all facts regarding the overpayment.

(2) Where the amount claimed as a credit is greater than the outstanding assessment of tax, a taxpayer desiring to obtain such credit and the refund to which he is entitled shall file, in addition to the claim for credit required to be made on form 47 A for the amount of the outstanding assessment, a claim for refund of the overpayment in excess of the credit. See article 1036. This claim for refund may be attached to the claim for credit or it may be separately filed with the Commissioner. All the facts regarding the total overpayment should be stated in the claim for refund and a reference made to such claim in the claim for credit.

ART. 1035. Action on claims for credit.—Upon receipt of a claim for credit on form 47 A the collector shall certify thereon the required information concerning all outstanding assessments and payments covered thereby and shall note on his records that a claim for credit has been filed. He shall thereupon transmit the claim to the Commissioner. Due notice will be given the collector and the taxpayer of the action taken on the claim. A schedule of credit claims on form 7220 A will be transmitted to the collector once a month and formal credit shall be taken by the collector at that time. If a claim is allowed against additional taxes due for other years, but such other taxes have not yet been assessed, only the amount of the excess of such taxes over the overpayment shall be assessed, or the excess of the overpayment over such other taxes due shall be refunded, as the case may be. A taxpayer desiring to convert a claim for refund previously filed into a claim for credit may file with the collector a claim on form 47 A, referring in it to such claim for refund. Upon its receipt by the Commissioner the claim for credit will be attached to the claim for refund and will be adjusted in the same manner as if the taxpayer had originally filed the claim for credit. The effective date of filing of the claim for credit shall be the actual date of filing such claim with the collector. The filing of a claim for credit against a tax due under another return shall be subject to the same rules with respect to the addition of interest and penalties as if the taxpayer had filed a claim for abatement of the tax against which credit is desired. See articles 1003 and 1006.

ART. 1036. Claims for refund of taxes erroneously collected.—Claims by the taxpayer for the refunding of taxes and penalties erroneously or illegally collected shall be made on form 46. In this case, as in that of claims for abatement, the burden of proof rests upon the claimant. All the facts relied upon in support of the claim should be clearly set forth under oath. It should be accompanied by the collector's receipt or the cancelled check showing payment of the tax. In the case of a taxpayer's death, certified copies of the letters of administration or letters testamentary, or other similar evidence, should be annexed to the claim to show the authority of the administrator or executor. The affidavit may be made by an agent of the person assessed, but in such a case a power of attorney must accompany the claim. Warrants in payment of claims allowed will be drawn in the names of the persons entitled to the money and shall unless otherwise directed be sent by the Treasurer of the United States directly to the proper persons or their duly authorized attorneys or agents. See further Regulations No. 14 (revised). In the case of mere overpayments by taxpayers the collector may repay the excess, subject to confirmation by the Commissioner of a claim for the refunding of such payments made by the collector on form 751 (revised). The Commissioner has no authority to refund on equitable grounds penalties legally collected.

ART. 1037. Suits for recovery of taxes erroneously collected.—No suit shall be maintained in any court for the recovery of any tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, until an appeal by a claim for credit or refund shall have been duly made to the Commissioner and a decision of the Commissioner has been had therein, unless such decision is delayed more than six months. The cause of action accrues upon an unfavorable decision by the Commissioner or at the expiration of six months after an appeal without action thereon, and no suit may be brought after two years from the time the cause of action accrued. No suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court. "Restraining" is used in its broad popular sense of hindering or impeding, as well as prohibiting or staying, and the provision is not limited in its application to suits for injunctive relief. The prohibition of such suits cannot be waived by any officer of the Government. See sections 3224, 3225 (as amended by the Revenue Act of 1918), 3226 (as amended by the Act of February 27, 1877) and 3227 of the Revised Statutes.

ART. 1038. Claims for refund of sums recovered by suit.—(a) Claims by taxpayers for the amount of a judgment representing taxes or penalties erroneously collected should be made on form 46. 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 received by the clerk or other proper officer of the court, together with a certified copy of the docket entries of the court in the case or so much thereof as may be required by the Commissioner. When a recovery is had in any suit or proceeding against a collector or other officer of the revenue for any act done by him, or for the recovery of any money exacted by or paid to him and by him paid into the Treasury, in the performance of his official duty, and the court certifies that there was probable cause for the act done by the collector or other officer, or that he acted under the directions of the Secretary of the Treasury, or other proper officer of the Government, no execution shall issue against such collector or other officer, but the amount so recovered shall, upon final judgment, be provided for and paid out of the proper appropriation from the Treasury. See section 989 of the Revised Statutes. (b) If the judgment debtor shall have already paid the amount recovered against him, the claim should be made in his name. There should also be a certificate of the clerk of the court in which the judgment was recovered (or other satisfactory evidence), showing that the judgment has been satisfied and specifying the exact sum paid in its satisfaction, with a detail of all items of costs which were paid by the judgment debtor or for which he is liable. See further article 1031 and Regulations No. 14 (revised).

PENALTIES.

SEC. 253. That any individual, corporation, or partnership required under this title to pay or collect any tax, to make a return or to supply information, who fails to pay or collect such tax, to make such return, or to supply such information at the time or times required under this title, shall be liable to a penalty of not more than \$1,000. Any individual, corporation, or partnership, or any officer or employee of any corporation or member or employee of a partnership, who willfully refuses to pay or collect such tax, to make such return, or to supply such information at the time or times required under this title, or who willfully attempts in any manner to defeat or evade the tax imposed by this title, shall be guilty of a misdemeanor and shall be fined not more than \$10,000 or imprisoned for not more than one year, or both, together with the costs of prosecution.

ART. 1041. Specific penalties.—A penalty of not more than \$1,000 attaches for failure punctually to make a required return, whether of income, withholding or information, or to pay or collect a required tax. If the failure is willful, however, or an attempt is made to defeat or evade the tax, the offender is liable to imprisonment

and to a fine of not more than \$10,000 and costs. See also the Act of July 5, 1884. In addition to these specific penalties ad valorem penalties are imposed in various cases. An ad valorem penalty is assessed and collected as a part of the tax, while a specific penalty is recoverable only by suit. See section 250 of the statute and articles 1004, 1005 and 1006.

RETURNS OF PAYMENTS OF DIVIDENDS.

SEC. 254. That every corporation subject to the tax imposed by this title and every personal service corporation shall, when required by the Commissioner, render a correct return duly verified under oath, of its payments of dividends, stating the name and address of each stockholder, the number of shares owned by him, and the amount of dividends paid to him.

ART. 1051. Return of information as to payments of dividends.—When directed by the Commissioner, either specially or by general regulation, every domestic or resident foreign corporation and every personal service corporation shall render a return on form 1097 of its payments of dividends and distributions to stockholders for such period as may be specified, stating the name and address of each stockholder, the number and class of shares owned by him, the date and amount of each dividend paid him, and when the surplus out of which it was paid was accumulated.

RETURNS OF BROKERS.

SEC. 255. That every individual, corporation, or partnership doing business as a broker shall, when required by the Commissioner, render a correct return duly verified under oath, under such rules and regulations as the Commissioner, with the approval of the Secretary, may prescribe, showing the names of customers for whom such individual, corporation, or partnership has transacted any business, with such details as to the profits, losses, or other information which the Commissioner may require, as to each of such customers, as will enable the Commissioner to determine whether all income tax due on profits or gains of such customers has been paid.

ART. 1061. Return of information by brokers.—When directed by the Commissioner, either specially or by general regulation, every person doing business as a broker shall render a return on form 1100, showing the names and addresses of customers to whom payments were made or for whom business was transacted during the calendar year or other specified period next preceding and giving the other information called for by the form.

INFORMATION AT SOURCE.

SEC. 256. That all individuals, corporations, and partnerships, in whatever capacity acting, including lessees or mortgagors of real

or personal property, fiduciaries, and employers, making payment to another individual, corporation, or partnership, of interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed, or determinable gains, profits, and income (other than payments described in sections 254 and 255), of \$1,000 or more in any taxable year, or, in the case of such payments made by the United States, the officers or employees of the United States having information as to such payments and required to make returns in regard thereto by the regulations hereinafter provided for, shall render a true and accurate return to the Commissioner, under such regulations and in such form and manner and to such extent as may be prescribed by him with the approval of the Secretary, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment.

Such returns may be required, regardless of amounts, (1) in the case of payments of interest upon bonds, mortgages, deeds of trust, or other similar obligations of corporations, and (2) in the case of collections of items (not payable in the United States) of interest upon the bonds of foreign countries and interest upon the bonds of and dividends from foreign corporations by individuals, corporations, or partnerships, undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange.

When necessary to make effective the provisions of this section the name and address of the recipient of income shall be furnished upon demand of the individual, corporation, or partnership paying the income.

The provisions of this section shall apply to the calendar year 1918 and each calendar year thereafter, but shall not apply to the payment of interest on obligations of the United States.

ART. 1071. Return of information as to payments of \$1,000.—All persons making payment to another person of fixed or determinable income of \$1,000 or more in a taxable year must render a return thereof to the Commissioner (Sorting Division) for the preceding calendar year on or before March 15 of each year, except as specified in articles 1073, 1074, 1075, 1076 and 1079. The return shall be made in each case on form 1099 (revised), accompanied by a letter of transmittal on form 1096 (revised) showing the number of returns filed and the aggregate amount represented by the payments. The street and number where the recipient of the payment lives and whether he is single, married or head of a family should be stated, if possible. Where no present address is available, the last known post-office address must be given. Although to make necessary a return of information the income must be fixed or determinable, it need not be annual or periodical. See article 362.

ART. 1072. Return of information as to payments to employees.—The names of all employees to whom payments exceeding \$1,000 a year are made, whether such total sum is made up of wages, salaries, commissions or compensation in any other form, must be reported. Heads of

branch offices and subcontractors employing labor, who keep the only complete record of payments therefor, should file returns of information in regard to such payments directly with the Commissioner. When both main office and branch office have adequate records, the return should be filed by the main office. In the case of an employer having a large number of employees who are moved from place to place as the exigencies of the service require, and who consequently has no complete record of annual payments to them at any one place, the salary of two representative months may be taken to establish a fair monthly wage, and unless the yearly payment based on this estimate in the case of an employee amounts to \$1,000 or more, no return of payments to such employee is required. See articles 32-34.

ART. 1073. Return of information by partnerships, personal service corporations and fiduciaries.—Partnerships and personal service corporations shall prepare reports on form 1099 (revised) for each member of the partnership or personal service corporation, and fiduciaries shall prepare such reports for each beneficiary of the estate or trust, showing in every case the distributive shares of the members or beneficiaries, whether or not actually distributed. The words "Partnership," "Personal service corporation" or "Fiduciary," as the case may be, should be entered on the blank line of the form under "Kind of income paid." Such reports on form 1099 (revised) are to be filed with the collector with the returns of income of such partnerships, personal service corporations or fiduciaries, instead of being transmitted to the Commissioner accompanied by form 1096 (revised).

ART. 1074. Cases where no return of information required.—Payments of the following character, although over \$1,000, need not be reported in returns of information on form 1099 (revised): (a) payments of interest on obligations of the United States; (b) dividends paid by domestic or resident foreign corporations (other than distributions by personal service corporations); (c) payments by a broker to his customers; (d) payments made to corporations; (e) bills paid for merchandise, telegrams, telephone, freight, storage and similar charges; (f) payments to employees for board and lodging while traveling in the course of their employment; (g) annuities representing the return of capital; (h) payments of rent made to real estate agents (but the agent must report payments to the landlord if they amount to \$1,000 or more annually); (i) payments made by branches of business houses located in foreign countries to alien employees serving in foreign countries; and (j) payments made by the United States Government to sailors and soldiers and to its civilian employees.

ART. 1075. Return of information as to interest on corporate bonds.—In the case of payments of interest, regardless of amount, upon bonds

and similar obligations of domestic or resident foreign corporations, the original ownership certificates, when duly filed, shall constitute and be treated as returns of information. If a bondholder files no ownership certificate in the case of payments of interest on registered bonds, the withholding agent shall make out such a certificate in each instance and file it with his monthly return. See sections 221 and 237 of the statute and articles 361-376.

ART. 1076. Return of information as to payments to nonresident aliens.—In the case of payments of annual or periodical income to nonresident alien individuals or to foreign corporations not engaged in trade or business within the United States and not having any office or place of business therein, the returns by withholding agents on forms 1098 (revised) and 1042 (revised) shall constitute and be treated as returns of information. See sections 221 and 237 of the statute and articles 361-376.

ART. 1077. Source of information as to foreign items.—The term "foreign item," as here used, means any dividend upon the stock of a nonresident foreign corporation or any item of interest upon the bonds of foreign countries or nonresident foreign corporations, whether or not such dividend or interest is paid in the United States or by check drawn on a domestic bank. (a) Wherever a foreign country or nonresident foreign corporation issuing bonds has appointed a paying agent in this country, charged with the duty of paying the interest upon such bonds, such paying agent shall be the source of information. If such foreign country or foreign corporation has no such agent, then the last bank or collecting agent in this country shall be the source of information. (b) In the case of dividends on the stock of a nonresident foreign corporation, however, the first bank or collecting agent accepting such item for collection shall be the source of information.

ART. 1078. Ownership certificates for foreign items.—(a) Where bonds of foreign countries, or bonds or stocks of nonresident foreign corporations, are owned by citizens or residents of the United States, individual or fiduciary, or by domestic or resident foreign corporations or partnerships, ownership certificate form 1001 A (revised) shall be executed by the actual owner or by his duly authorized agent when presenting the item for collection, whether such item is a dividend or an interest payment, except in the case of a foreign country or a foreign corporation having a fiscal agent in this country and issuing bonds which contain a tax-free covenant clause. In such a case the fiscal agent is required to withhold the normal tax upon the interest on such bonds and ownership certificate form 1000 (revised), modified to show the name and address of the fiscal agent, should be used, unless the owner (if so entitled) desires to claim exemption, in which case form 1001 A (revised) should be filed. (b) Where such

foreign bonds or stocks are owned by nonresident alien individuals, corporations or partnership, ownership certificate form 1001 A (revised) shall be used on behalf of such owners by any responsible bank or banker, either foreign or domestic, having knowledge of such ownership. In such a case the bank or banker need not fill in the names of the owners.

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 (Sorting Division) on or before the 20th day of the month following that during which the items were accepted, accompanied by a return on form 1096 A showing the number of certificates and the aggregate amount of foreign items disclosed thereon. An annual return on form 1096 B shall be forwarded to the Commissioner not later than March 15 of each year, on which shall be given a summary of the monthly returns. (b) In the case of interest items, as to which the paying agent or the last bank or collecting agent in this country is the source of information, the ownership certificate shall accompany the coupon to such agent or source of information, who shall forward the ownership certificate to the Commissioner in the same manner as above provided with respect to dividend items. Where ownership certificate form 1000 (revised) is used, a monthly return shall be made on form 1012 (revised) and an annual return on form 1013 (revised), as provided in articles 361–376. Forms 1012 (revised) and 1013 (revised), when so used, should be modified to show the name and address of the paying agent. The use of substitute certificates is not permitted in the collection of foreign items.

ART. 1080. Information as to actual owner.—When the person receiving a payment falling within the provisions of the statute for information at the source is not the actual owner of the income received, the name and address of the actual owner shall be furnished upon demand of the individual, corporation or partnership paying the income, and in default of a compliance with such demand the payee becomes liable to the penalties provided. See section 253 of the statute and article 1041.

RETURNS TO BE PUBLIC RECORDS.

SEC. 257. That returns upon which the tax has been determined by the Commissioner shall constitute public records; but they shall be

open to inspection only upon order of the President and under rules and regulations prescribed by the Secretary and approved by the President: *Provided*, That the proper officers of any State imposing an income tax may, upon the request of the governor thereof, have access to the returns of any corporation, or to an abstract thereof showing the name and income of the corporation, at such times and in such manner as the Secretary may prescribe: *Provided further*, That all bona fide stockholders of record owning 1 per centum or more of the outstanding stock of any corporation shall, upon making request of the Commissioner, be allowed to examine the annual income returns of such corporation and of its subsidiaries. Any stockholder who pursuant to the provisions of this section is allowed to examine the return of any corporation, and who makes known in any manner whatever not provided by law the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any such return, shall be guilty of a misdemeanor and be punished by a fine not exceeding \$1,000, or by imprisonment not exceeding one year, or both.

The Commissioner shall as soon as practicable in each year cause to be prepared and made available to public inspection in such manner as he may determine, in the office of the collector in each internal-revenue district and in such other places as he may determine, lists containing the names and the post-office addresses of all individuals making income-tax returns in such district.

ART. 1091. Inspection of returns.—The returns upon which the tax has been determined by the Commissioner, although public records, are open to inspection only to the extent authorized by the President, except as otherwise expressly provided. Pursuant to a similar provision of the Act of October 3, 1913, the President by an executive order dated July 28, 1914, directed that returns of income should be subject to inspection in accordance with the following regulations prescribed by the Secretary of the Treasury:

1. The return of every individual, and of every corporation, joint stock company or association, and every insurance company, whether foreign or domestic, shall be open to the inspection of the proper officers and employees of the Treasury Department. Returns of individuals shall not be subject to inspection by anyone except the proper officers and employees of the Treasury Department.

2. Where access to any return of any corporation is desired by an officer or employee of any other department of the Government, an application for permission to inspect such return, setting out the reasons therefor, shall be made in writing, signed by the head of the executive department or other Government establishment in which such officer or employee is employed, and transmitted to the Secretary of the Treasury. If the return of a corporation is desired to be used in any legal proceedings other than those to which the United States is a party, or to be used in any manner by which any information contained in the return could be made public, the application for permission to inspect such return or to furnish a certified copy thereof shall be referred to the Attorney General, and if recommended by him transmitted to the Secretary of the Treasury.

3. All returns, whether of persons or of corporations, joint stock companies or associations, or insurance companies, may be furnished, upon approval of the Secretary of the Treasury, for use, either in the original or by certified copies thereof, in any legal proceedings before any United States grand jury or in the trial of any cause to which both the United States and the person or corporation or association rendering the return are parties either as plaintiff or defendant, and in the prosecution or defense or trial of which action, or proceedings before a grand jury, such return would constitute material evidence, but in any case arising in the collection of the income tax, the Commissioner of Internal Revenue may furnish for use to the proper officer either the original or certified copies of returns without the approval of the Secretary of the Treasury. In all cases where the use of the original return is necessary, it shall be placed in evidence by the Commissioner of Internal Revenue or by some officer of the Bureau of Internal Revenue designated by him for that purpose, and after such original return has been placed in evidence it shall be returned to the files in the office of the Commissioner of Internal Revenue at Washington, D. C.

4. The Secretary of the Treasury, at his discretion, upon application to him made, setting forth what constitutes a proper showing of cause, may permit inspection of the return of any corporation, by any bona fide stockholder in such corporation. The person desiring to inspect such return shall make application in writing, to the Secretary of the Treasury, setting forth the reasons why he should be permitted to make such inspection, and shall attach to his application a certificate, signed by the president, or other principal officer, of such corporation, countersigned by the secretary, under the corporate seal of the company, that he is a bona fide stockholder in said company. (Where this certificate can not be secured, other evidence will be considered by the Secretary of the Treasury to determine the fact whether or not the applicant is a bona fide stockholder and, therefore, entitled to inspect the return made by such company.) Upon receipt of such application the corporation whose return it is desired to inspect shall be notified of the facts and shall be given opportunity to state whether any legitimate reason exists for refusing permission to inspect its returns of annual net income by the stockholder applying for permission to make such inspection. The privilege of inspecting the return of any corporation is personal to the stockholders, and the permission granted by the Secretary to a stockholder to make such inspection can not be delegated to any other person.

5. The returns of the following corporations shall be open to the inspection of any person upon written application to the Secretary of the Treasury, which application shall set forth briefly and succinctly all facts necessary to enable the Secretary to act upon the request: (a) the returns of all companies whose stock is listed upon any duly organized and recognized stock exchange within the United States, for the purpose of having its shares dealt in by the public generally; (b) all corporations whose stock is advertised in the press or offered to the public by the corporation itself for sale. In case of doubt as to whether any company falls within the classification above, the person desiring to see such return should make application, supported by advertisements, prospectus, or such other evidence as he may deem proper to establish the fact that the stock of such corporation is offered for general public

sale. Returns can be inspected only in the office of the Commissioner of Internal Revenue, in Washington, D. C. In no case shall any collector, or any other internal revenue officer outside of the Treasury Department in Washington, permit to be inspected any return or furnish any information whatsoever relative to any return or any information secured by him in his official capacity relating to such return, except in answer to a proper subpoena, in a case to which the United States is a party.

6. Returns of individuals shall not be open to the inspection of any person other than the proper officers and employees of the Treasury Department or person rendering the same, and are under no conditions to be made public, except where such publicity shall result through the use of such returns in any legal proceedings in which the United States is a party.

7. Upon request of the governor of a State imposing a general income tax, the proper officer of such State, to be designated by name and official position by the governor of such State in his application to the Secretary of the Treasury, may have access to the returns or to abstracts thereof showing the name and income of each corporation, joint stock company or association, or insurance company, at such times and in such manner as the Secretary of the Treasury may prescribe. Such application shall be made in writing, addressed to the Secretary of the Treasury and shall show (first) that the State, whose governor makes the request, imposes a general income tax; (second) the name and address of each corporation, etc., to which access is desired; (third) why permission to inspect the returns of the corporations, etc., named in the request is desired, and (fourth) what officer or officers are designated to make the desired inspection, giving their names and official designations. Such request must be signed by the governor of the State and sealed with the seal thereof, and shall be transmitted to the Secretary of the Treasury for his consideration and action thereon.

No provision is made in the law for furnishing a copy of any return to any person or corporation, and no copy of any return will be furnished to any other than the person or corporation making the return, or their duly constituted attorney, except as hereinbefore authorized.

The provisions herein contained shall be effective on and after the 1st day of September, 1914.

A person having the privilege of inspection will not be furnished a copy of the return, but may make a copy or take notes for his own or an authorized use. Beneficiaries of an estate or trust are not entitled as such to an inspection of returns of income filed by the fiduciary. A receiver of a corporation is entitled to have access to its returns. See also sections 326 (a) (2) and 328 (c) of the statute.

ARR. 1092. Inspection of returns by State.—By express exception in the statute 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 returns of income of any corporation or to an abstract thereof showing its name and income. Upon written application by the governor of a State as prescribed in paragraph 7 of article 1091,

except that the application may be made directly to the Commissioner instead of to the Secretary, the Commissioner will set a convenient time for inspection of the returns (or an abstract thereof as he may determine) of corporations organized or doing business in such State. The authority to inspect returns granted to officers of a State includes authority to inspect lists furnished to supplement and become a part of the returns.

ART. 1093. *Inspection of returns by stockholder.*—By express exception in the statute a bona fide stockholder of record owning one per cent of the outstanding stock of a corporation is entitled as of right to examine the returns of income of such corporation and its subsidiaries. A stockholder desiring the privilege of inspection shall apply in writing to the Commissioner, specifying his address, the name of the corporation, its outstanding capital stock, the number of shares owned by him, the date of their acquisition and whether or not he has the beneficial as well as the record title to such shares, and in other respects complying with the requirements of paragraph 4 of article 1091. A stockholder who has acquired his shares for the purpose of inspection of the income returns of the corporation is not a bona fide stockholder.

ART. 1094. *Penalties for disclosure of returns.*—A stockholder who examines the return of a corporation and reveals without express authority of law any particulars of its income statement is guilty of a misdemeanor and liable to fine and imprisonment. Section 3167 of the Revised Statutes, as amended by section 1317 of the Revenue Act of 1918, also provides:

SEC. 3167. It shall be unlawful for any collector, deputy collector, agent, clerk, or other officer or employee of the United States to divulge or to make known in any manner whatever not provided by law to any person the operations, style of work, or apparatus of any manufacturer or producer visited by him in the discharge of his official duties, or the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any income return, or to permit any income return or copy thereof or any book containing any abstract or particulars thereof to be seen or examined by any person except as provided by law; and it shall be unlawful for any person to print or publish in any manner whatever not provided by law any income return, or any part thereof or source of income, profits, losses, or expenditures appearing in any income return; and any offense against the foregoing provision shall be a misdemeanor and be punished by a fine not exceeding \$1,000 or by imprisonment not exceeding one year, or both, at the discretion of the court; and if the offender be an officer or employee of the United States he shall be dismissed from office or discharged from employment.

An internal revenue officer discovering in the course of his duty information leading him to suspect a possible violation of any law with the enforcement of which he is not directly concerned should

immediately report the matter to the Commissioner, who is authorized to communicate with the proper department involved.

PUBLICATION OF STATISTICS.

SEC. 258. That the Commissioner, with the approval of the Secretary, shall prepare and publish annually statistics reasonably available with respect to the operation of the income, war-profits and excess-profits tax laws, including classifications of taxpayers and of income, the amounts allowed as deductions, exemptions, and credits, and any other facts deemed pertinent and valuable.

ART. 1101. Statistics of income.—The Commissioner will publish annually a volume of statistics of income, showing, among other things, the distribution of incomes between corporations and individuals and by States, by classes and by occupations.

COLLECTION OF FOREIGN ITEMS.

SEC. 259. That all individuals, corporations, or partnerships undertaking as a matter of business or for profit the collection of foreign payments of interest or dividends by means of coupons, checks, or bills of exchange shall obtain a license from the Commissioner and shall be subject to such regulations enabling the Government to obtain the information required under this title as the Commissioner, with the approval of the Secretary, shall prescribe; and whoever knowingly undertakes to collect such payments without having obtained a license therefor, or without complying with such regulations, shall be guilty of a misdemeanor and shall be fined not more than \$5,000, or imprisoned for not more than one year, or both.

ART. 1111. License to collect foreign items.—Banks or agents collecting foreign items, as defined in article 1077, and required by article 1079 to make returns of information with respect thereto, must obtain a license from the Commissioner to engage in such business. Application form 1017 for such license may be procured from collectors. The license is issued without cost on form 1010. Foreign items shall not be accepted for collection by any bank or collecting agent so licensed unless properly indorsed or accompanied by proper ownership certificates giving all the information called for by such certificate. See section 256 and articles 1077–1079.

CITIZENS OF UNITED STATES POSSESSIONS.

SEC. 260. That any individual who is a citizen of any possession of the United States (but not otherwise a citizen of the United States) and who is not a resident of the United States, shall be subject to taxation under this title only as to income derived from sources within the United States, and in such case the tax shall be computed and paid in the same manner and subject to the same conditions as in the case of other persons who are taxable only as to income derived from such sources.

ART. 1121. Status of citizen of United States possession.—A citizen of a possession of the United States, who is not otherwise a citizen or a resident of the United States, including only the States, the Territories of Alaska and Hawaii, and the District of Columbia, is treated for the purpose of the tax as if he were a nonresident alien individual. See articles 91-93, 271, 306, 307, 311, 316 and 404. His income from sources within the United States is subject to withholding. See section 221 and articles 361-376.

PORTO RICO AND PHILIPPINE ISLANDS.

SEC. 261. That in Porto Rico and the Philippine Islands the income tax shall be levied, assessed, collected, and paid in accordance with the provisions of the Revenue Act of 1916 as amended.

Returns shall be made and taxes shall be paid under Title I of such Act in Porto Rico or the Philippine Islands, as the case may be, by (1) every individual who is a citizen or resident of Porto Rico or the Philippine Islands or derives income from sources therein, and (2) every corporation created or organized in Porto Rico or the Philippine Islands or deriving income from sources therein. An individual who is neither a citizen nor a resident of Porto Rico or the Philippine Islands but derives income from sources therein, shall be taxed in Porto Rico or the Philippine Islands as a nonresident alien individual, and a corporation created or organized outside Porto Rico or the Philippine Islands and deriving income from sources therein shall be taxed in Porto Rico or the Philippine Islands as a foreign corporation. For the purposes of section 216 and of paragraph (6) of subdivision (a) of section 234 a tax imposed in Porto Rico or the Philippine Islands upon the net income of a corporation shall not be deemed to be a tax under this title.

The Porto Rican or Philippine Legislature shall have power by due enactment to amend, alter, modify, or repeal the income tax laws in force in Porto Rico or the Philippine Islands, respectively.

ART. 1131. Income tax in Porto Rico and Philippine Islands.—In Porto Rico and the Philippine Islands the Revenue Act of 1916, as amended, is in force and the Revenue Act of 1918 is not. 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 taxed 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 381-384. (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 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 taxed in both places. In the case of the United States corporation the income, war profits and excess profits taxes in the United States are credited with the amount of any income, war profits and excess profits taxes paid in Porto Rico. In the case of the Porto Rico corporation there is no such credit. See section 238 of the statute and article 611. The corporation of the foreign country deriving income from both places is subject to no double taxation so far as the United States and Porto Rico are concerned. For the purpose of withholding a Porto Rico corporation is a foreign corporation. See section 237 and article 601. The same principles apply in the case of the Philippine Islands.

PART IV.

DEFINITIONS AND GENERAL PROVISIONS.

GENERAL DEFINITIONS.

SECTION 1. That when used in this Act—

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

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

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

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

The term "United States" when used in a geographical sense includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia;

The term "Secretary" means the Secretary of the Treasury;

The term "Commissioner" means the Commissioner of Internal Revenue;

The term "collector" means collector of internal revenue;

The term "Revenue Act of 1916" means the Act entitled "An Act to increase the revenue, and for other purposes," approved September 8, 1916;

The term "Revenue Act of 1917" means the Act entitled "An Act to provide revenue to defray war expenses, and for other purposes," approved October 3, 1917;

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

The term "Government contract" means (a) a contract made with the United States, or with any department, bureau, officer, commission, board, or agency, under the United States and acting in its behalf, or with any agency, controlled by any of the above if the contract is for the benefit of the United States, or (b) a subcontract made with a contractor performing such a contract if the products or services to be furnished under the subcontract are for the benefit of the United States. The term "Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive" when applied to a contract of the kind referred to in clause (a) of this paragraph, includes all such contracts which, although entered into during such period, were originally not enforceable, but which have been or may become enforceable by reason of subsequent validation in pursuance of law;

The term "military or naval forces of the United States" includes the Marine Corps, the Coast Guard, the Army Nurse Corps, Female, and the Navy Nurse Corps, Female, but this shall not be deemed to exclude other units otherwise included within such term;

The term "present war" means the war in which the United States is now engaged against the German Government.

For the purposes of this Act the date of the termination of the present war shall be fixed by proclamation of the President.

ART. 1501. Person.—The statute recognizes three chief classes of persons, to wit, individuals, partnerships and corporations. Corporations include associations, joint-stock companies and insurance companies, but not partnerships properly so-called. A taxpayer is any person, trust or estate subject to tax.

ART. 1502. Association.—Associations and joint-stock companies include associations, common law trusts and organizations by whatever name known, which act or do business in an organized capacity, whether created under and pursuant to State laws, agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the members or shareholders on the basis of the capital stock which each holds or, where there is no capital stock, on the basis of the proportionate share or capital which each has or has invested in the business or property of the organization.

ART. 1503. Association distinguished from partnership.—An organization the membership interests in which are transferable without the consent of all the members, however the transfer may be otherwise restricted, and the business of which is conducted by trustees or directors and officers without the active participation of all the members as such, is an association and not a partnership. A partnership bank conducted like a corporation and so organized that the interests of its members may be transferred without the consent of the other members is a joint-stock company or association within the meaning of the statute. A partnership bank the interests of whose members can not be so transferred is a partnership.

ART. 1504. Association distinguished from trust.—Where trustees hold real estate subject to a lease and collect the rents, doing no business other than distributing the income less taxes and similar expenses to the holders of their receipt certificates, who have no control except the right of filling a vacancy among the trustees and of consenting to a modification of the terms of the trust, no association exists and the cestuis que trust are liable to tax as beneficiaries of a trust the income of which is to be distributed periodically, whether or not at regular intervals. But in such a trust if the trustees pursuant to the terms thereof have the right to hold the income for future distribution, the net income is taxed to the trustees instead of to the beneficiaries. See section 219 of the statute

and articles 341-346. If, however, the cestuis quæ 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. Michigan and Virginia partnership associations are corporations. Such a corporation may or may not be a personal service corporation. See sections 200 and 218 of the statute and articles 1523-1532.

ART. 1507. Joint ownership and joint adventure.—Joint investment in and ownership of real and personal property not used in the operation of any trade or business and not covered by any partnership agreement does not constitute a partnership. Co-owners of oil lands engaged in the joint enterprise of developing the property through a common agent are not necessarily partners. In the absence of special facts affirmatively showing an association or partnership, where a vessel is owned by several individuals and operated by a managing owner or agent for the account of all, the relation does not constitute either a joint-stock association or a partnership. The

participation of two United States corporations in a joint enterprise or adventure does not constitute them partners.

ART. 1508. Insurance company.—Insurance companies include both stock and mutual companies, as well as mutual benefit insurance companies. A voluntary unincorporated association of employees formed for the purpose of relieving sick and aged members and the dependents of deceased members is an insurance company, whether the fund for such purpose is created wholly by membership dues or partly by contributions from the employer. But a corporation which merely sets aside a fund for the insurance of its employees is not required to file a separate return for such fund if the income and disbursements therefrom are included in the corporation's own return. See sections 231, 233, 234 and 239 of the statute and articles 521, 548, 549, 568–572, 623 and 870.

ART. 1509. Domestic and foreign persons.—A domestic corporation or partnership is one organized or created in the United States, including only the States, the Territories of Alaska and Hawaii, and the District of Columbia, and a foreign corporation or partnership is one organized or created outside the United States as so defined. The nationality or residence of members of a partnership does not affect its status. A partnership created by articles entered into in San Francisco between residents of the United States and residents of China is a domestic partnership. A foreign corporation engaged in trade or business within the United States or having an office or place of business therein is sometimes referred to in the regulations as a resident foreign corporation and a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein as a nonresident foreign corporation. See also articles 4 and 312–315.

ART. 1510. Government contract.—Government contracts may include (a) a contract with the United States, (b) a contract with an agency of the United States, (c) a contract with an agency of such agency, and (d) a subcontract with a contractor under any such contract; provided in every case the contract or subcontract is for the benefit of the United States. Unenforceable contracts subsequently ratified are treated as though made when originally executed. The Commissioner may require any contractor to file with him copies of his Government contracts entered into on or after April 6, 1917, and shall have access to the information in the possession of the Government relating to such contracts. See section 1408 of the statute. The realization by a corporation of income from a Government contract may affect its status under the consolidated returns provision and the amount of its war profits and excess profits tax. See sections 240, 301 (c), 311 (d), 327 (d) and 200 and articles 635, 714, 719, 784 and 1524. The agreements for the operation of transportation systems

while under federal control and for the just compensation of their owners made pursuant to the Act of March 21, 1918, are not Government contracts within the meaning of this article. See sections 230 and 301 (e) and article 504.

DEFINITIONS.

Sec. 200. That when used in this title—

The term "taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under section 212 or section 232. The term "fiscal year" means an accounting period of twelve months ending on the last day of any month other than December. The first taxable year, to be called the taxable year 1918, shall be the calendar year 1918 or any fiscal year ending during the calendar year 1918;

The term "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person, trust or estate;

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

The term "personal service corporation" means a corporation whose income is to be ascribed primarily to the activities of the principal owners or stockholders who are themselves regularly engaged in the active conduct of the affairs of the corporation and in which capital (whether invested or borrowed) is not a material income-producing factor; but does not include any foreign corporation, nor any corporation 50 per centum or more of whose gross income consists either (1) of gains, profits, or income derived from trading as a principal, or (2) of gains, profits, commissions, or other income, derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive;

The term "paid," for the purpose of the deductions and credits under this title, means "paid or accrued" or "paid or incurred," and the terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212.

ART. 1521. Fiduciary.—"Fiduciary" is a term which applies to all persons that occupy positions of peculiar confidence toward others, such as trustees, executors and administrators, and a fiduciary for income tax purposes is a person who holds in trust an estate to which another has the beneficial title or in which another has a beneficial interest, or receives and controls income of another as in the case of receivers. A committee of the property of an incompetent person is a fiduciary. See sections 219 and 225 of the statute and articles 341-344 and 421-425.

ART. 1522. Fiduciary distinguished from agent.—There may be a fiduciary relationship between an agent and a principal, but the word "agent" does not denote a fiduciary. A fiduciary relationship can not be created by a power of attorney. An agent having entire charge of property, with authority to effect and execute leases with tenants entirely on his own responsibility and without consulting his principal,

merely turning over the net profits from the property periodically to his principal by virtue of authority conferred upon him by a power of attorney, is not a fiduciary within the meaning of the statute. In cases where no legal trust has been created in the estate controlled by the agent and attorney the liability to make a return rests with the principal.

ART. 1523. Personal service corporation.—The term “personal service corporation” means a corporation, not expressly excluded, the income of which is derived from a profession or business (a) which consists principally of rendering personal service, (b) the earnings of which are to be ascribed primarily to the activities of the principal owners or stockholders, and (c) in which the employment of capital is not necessary or is only incidental. No definite and conclusive tests can be prescribed by which it can be finally determined in advance of an examination of the corporation’s return whether or not it is a personal service corporation. In the following articles are laid down the general principles under which such determination will be made. See also section 303 of the statute and articles 741–743.

ART. 1524. Personal service corporation: certain corporations excluded.—The following classes of corporations are expressly excluded from classification as personal service corporations: (a) foreign corporations; (b) corporations 50 per cent or more of whose gross income consists of gains, profits or income derived from trading as a principal; and (c) corporations 50 per cent or more of whose gross income consists of gains, profits, commissions or other income derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, inclusive. See article 1510. A corporation is not a personal service corporation merely because less than 50 per cent of its gross income was derived from trading as a principal or from Government contracts. A corporation can not be considered a personal service corporation when another corporation 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 non-personal 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.

ARR. 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 361-376. "Paid" is to be construed in each instance in the light of the method used in computing net income, whether on an accrual or a receipt basis. See article 23.

DIVIDENDS.

SEC. 201. (a) That the term "dividend" when used in this title (except in paragraph (10) of subdivision (a) of section 234) means (1) any distribution made by a corporation, other than a personal service corporation, to its shareholders or members, whether in cash or in other property or in stock of the corporation, out of its earnings or profits accumulated since February 28, 1913, or (2) any such distribution made by a personal service corporation out of its earnings or profits accumulated since February 28, 1913, and prior to January 1, 1918.

(b) Any distribution shall be deemed to have been made from earnings or profits unless all earnings and profits have first been distributed. Any distribution made in the year 1918 or any year thereafter shall be deemed to have been made from earnings or profits accumulated since February 28, 1913, or, in the case of a personal service corporation, from the most recently accumulated earnings or profits; but any earnings or profits accumulated prior to March 1, 1913, may be distributed

in stock dividends or otherwise, exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed.

(c) A dividend paid in stock of the corporation shall be considered income to the amount of the earnings or profits distributed. Amounts distributed in the liquidation of a corporation shall be treated as payments in exchange for stock or shares, and any gain or profit realized thereby shall be taxed to the distributee as other gains or profits.

(d) If any stock dividend (1) is received by a taxpayer between January 1 and November 1, 1918, both dates inclusive, or (2) is during such period bona fide authorized or declared, and entered on the books of the corporation, and is received by a taxpayer after November 1, 1918, and before the expiration of thirty days after the passage of this Act, then such dividend shall, in the manner provided in section 206, be taxed to the recipient at the rates prescribed by law for the years in which the corporation accumulated the earnings or profits from which such dividend was paid, but the dividend shall be deemed to have been paid from the most recently accumulated earnings or profits.

(e) Any distribution made during the first sixty days of any taxable year shall be deemed to have been made from earnings or profits accumulated during preceding taxable years; but any distribution made during the remainder of the taxable year shall be deemed to have been made from earnings or profits accumulated between the close of the preceding taxable year and the date of distribution, to the extent of such earnings or profits, and if the books of the corporation do not show the amount of such earnings or profits, the earnings or profits for the accounting period within which the distribution was made shall be deemed to have been accumulated ratably during such period.

ART. 1541. Dividends.—Dividends for the purpose of the statute comprise any distribution in the ordinary course of business, even though extraordinary in amount, made by a domestic or foreign corporation to its shareholders out of its earnings or profits accumulated since February 28, 1913, and in the case of a personal service corporation prior to January 1, 1918. The mere declaration of a dividend is not a distribution. Dividends are income and are taxed at the rates for the year in which paid, regardless of when the earnings or profits out of which they were paid were accumulated. As to certain stock dividends see, however, article 1546. Although interest on State bonds and certain other obligations is not taxable when received by a corporation, upon amalgamation with the other funds of the corporation such income loses its identity and when distributed to stockholders in dividends is taxable to the same extent as other dividends. See further articles 54 and 858.

ART. 1542. Presumption as to source of distribution.—In the case of a corporation other than a personal service corporation any distribution to stockholders is deemed to have been made so far as possible (a) from earnings or profits; (b) during the year 1918 or thereafter from earnings or profits accumulated since February 28, 1913; (c), if during the first sixty days of a taxable year, from earnings or profits

accumulated during preceding taxable years; and (*d*), if during the remainder of a taxable year after the first sixty days, from earnings or profits accumulated during the taxable year up to the date of distribution. The presumption contained in clauses (*c*) and (*d*) affects the determination of invested capital for the purpose of the war profits and excess profits tax, but has no effect upon the rates at which dividends paid in 1918 and subsequent years are taxed. In ascertaining whether or not a distribution was made out of earnings or profits of the taxable year there should first be set aside a proper reserve for the payment of accrued income and war profits and excess profits taxes. See article 857. In the case of a personal service corporation any distribution is deemed to have been made so far as possible (*a*) from earnings or profits; (*b*) during the year 1918 or thereafter from earnings or profits accumulated since February 28, 1913; (*c*) if during the first sixty days of a taxable year, from the most recently accumulated earnings or profits of preceding taxable years; and (*d*) if during the remainder of the taxable year after the first sixty days, from earnings or profits accumulated during the taxable year up to the date of distribution.

ART. 1543. Distributions which are not dividends.—A distribution by a corporation out of earnings or profits accumulated prior to March 1, 1913, or out of any assets except earnings or profits accumulated since February 28, 1913, is not a dividend within the meaning of the statute. A distribution by a personal service corporation out of earnings or profits accumulated since December 31, 1917, is not a dividend. A distribution out of earnings or profits accumulated before March 1, 1913, is free from tax as a dividend; out of assets other than earnings or profits accumulated since February 28, 1913, may or may not be free from tax, according as each stockholder receives more or less than he paid for his stock or its fair market value as of March 1, 1913; and, in the case of a personal service corporation, out of earnings or profits accumulated since December 31, 1917, is taxed to the stockholders as though they were partners. See section 218 of the statute and articles 328-335. In determining whether a distribution is made out of earnings or profits accumulated after or before March 1, 1913, due consideration must be given to the facts and mere book entries increasing or decreasing the surplus will not be conclusive.

ART. 1544. Dividends paid in property.—Dividends paid in securities or other property (other than its own stock), in which the earnings of a corporation have been invested, are income to the recipients to the amount of the fair market value of such property when receivable by the stockholders. A dividend paid in stock of another corporation is not a stock dividend. Where a corporation declares a dividend payable in stock of another corporation, setting aside the stock

to be so distributed and notifying the stockholders of its action, the income arising to the recipients of such stock is its fair market value at the time the dividend becomes payable. See article 53. Scrip dividends are subject to tax in the year in which the warrants are issued.

ART. 1545. Stock dividends.—A dividend paid in stock of the corporation is income to the amount of the earnings or profits distributed, as shown by the transfer of surplus to capital account on the books of the corporation, usually equal to the par value of the stock distributed. But stock distributions made out of surplus other than earnings or profits accumulated since February 28, 1913, when there are no such earnings or profits, are not dividends within the meaning of the statute and are free from tax as dividends. Stock dividends paid from earnings or profits accumulated after February 28, 1913, received by a fiduciary and retained as an accretion to the estate under the terms of the will or trust, are income to the estate.

ART. 1546. Stock dividends of 1918.—By a special exception to the general rule any stock dividend received by a taxpayer between January 1 and November 1, 1918, or declared and credited to a stockholder during such period and received by him before March 27, 1919, is deemed to have been paid from the most recently accumulated earnings or profits and shall be taxed to the recipient at the rates prescribed for the years in which the corporation accumulated the earnings or profits so distributed. Thus, such a stock dividend will be deemed to have been paid from the earnings of 1918 (unless paid during the first sixty days of 1918), and the recipient, if an individual, will be liable to any surtax at the rates for the year 1918, unless at the time such dividend was paid or credited the current earnings up to that time were not sufficient to cover the distribution, in which case the excess over the earnings of the taxable year will be deemed to have been paid from the most recently accumulated surplus of prior years and will be taxed at the rate or rates for the year or years in which earned. A corporation declaring and paying such a stock dividend out of earnings accumulated over a period of years should make a record in its books of the amount of the dividend paid out of each year's undistributed profits and advise the stockholders accordingly. See section 206 of the statute and article 1642.

ART. 1547. Sale of stock received as dividend.—As stock dividends were taxable income under the Revenue Act of 1916, as well as the present statute, but were not under the Act of October 3, 1913, different considerations may apply to the sale of stock received as a dividend before 1916 and stock so received thereafter. See article 39. For the purpose of ascertaining the gain or loss derived from the sale of stock of a corporation received as a dividend, or from the sale of the stock in respect of which such dividend was paid, the cost (used to include also, where required, fair market price or value as of March 1,

1913) of such stock is to be determined in accordance with the following rules:

(1) In the case of stock (*a*) received as a dividend in 1913, 1914 or 1915 out of surplus however created, or (*b*) received as a dividend in 1916 or subsequent years out of surplus other than earnings or profits accumulated since February 28, 1913, the cost of each share of new stock is the quotient of the cost of the old stock divided by the number of old and new shares added together.

(2) In the case of the stock in respect of which any stock dividend was paid as described under (1), the cost of each share of old stock is similarly the quotient of the cost of the old stock divided by the number of old and new shares.

(3) In the case of stock received as a dividend in 1916 or subsequent years out of earnings or profits accumulated since February 28, 1913, the cost of each share of new stock is the quotient of the sum of (*a*) the cost of the old stock plus (*b*) the valuation at which the new stock was returnable as income (as shown by the transfer of surplus to capital account on the books of the corporation, usually its par value), divided by the number of old and new shares added together.

(4) In the case of the stock in respect of which any stock dividend was paid as described under (3), the cost of each share of old stock is similarly the quotient of the sum of (*a*) the cost of the old stock plus (*b*) the valuation at which the new stock was returnable as income, divided by the number of old and new shares.

ART. 1548. Distribution in liquidation.—So-called liquidation or dissolution dividends are not dividends within the meaning of the statute, and amounts so distributed, whether or not including any surplus earned since February 28, 1913, are to be regarded as payments for the stock of the dissolved corporation. Any excess so received over the cost of his stock to the stockholder, or over its fair market value as of March 1, 1913, if acquired prior thereto, is a taxable profit. A distribution in liquidation of the assets and business of a corporation, which is a return to the stockholder of the value of his stock upon a surrender of his interest in the corporation, is distinguishable from a dividend paid by a going corporation out of current earnings or accumulated surplus when declared by the directors in their discretion, which is in the nature of a recurrent return upon the stock.

ART. 1549. Distribution from depletion or depreciation reserve.—A reserve set up out of gross income by a corporation and maintained for the purpose of making good any loss of capital assets on account of depletion or depreciation is not a part of its surplus out of which ordinary dividends may be paid. A distribution made from such a reserve will be considered a liquidating dividend and

will constitute taxable income to a stockholder only to the extent that the amount so received is in excess of the cost or fair market value as of March 1, 1913, of his shares of stock. No distribution, however, will be deemed to have been made from such a reserve except to the extent that the amount paid exceeds the surplus and undivided profits of the corporation. In general, any distribution made by a corporation other than out of earnings or profits accumulated since February 28, 1913, is to be regarded as a return to the stockholder of part of the capital represented by his shares of stock, and upon a subsequent sale of such stock his profit will be the excess of the selling price over the cost of the stock or its fair market value as of March 1, 1913, after applying on such cost or value the amount of any such capital distribution.

BASIS FOR DETERMINING GAIN OR LOSS.

SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203.

(b) When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; but when in connection with the reorganization, merger, or consolidation of a corporation a person receives in place of stock or securities owned by him new stock or securities of no greater aggregate par or face value, no gain or loss shall be deemed to occur from the exchange, and the new stock or securities received shall be treated as taking the place of the stock, securities, or property exchanged.

When in the case of any such reorganization, merger or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock or securities exchanged, a like amount in par or face value of the new stock or securities received shall be treated as taking the place of the stock or securities exchanged, and the amount of the excess in par or face value shall be treated as a gain to the extent that the fair market value of the new stock or securities is greater than the cost (or if acquired prior to March 1, 1913, the fair market value as of that date) of the stock or securities exchanged.

ART. 1561. Basis for determining gain or loss from sale.—For the purpose of ascertaining the gain or loss from the sale or exchange of property the basis is (a) its fair market price or value as of March 1, 1913, if acquired prior thereto, or (b), if acquired on or after that date, its cost or its approved inventory value. In both cases proper adjustment must be made for any depreciation or depletion sustained. What the fair market price or value of property was on

March 1, 1913, is a question of fact to be established by any evidence which will reasonably and adequately make it appear. As to inventories see section 203 of the statute and articles 1581-1585. The fair market value as of March 1, 1913, has no bearing on the determination of the invested capital of a corporation for the purpose of the war profits and excess profits tax. See section 326 and article 831.

ART. 1562. Sale of property acquired by gift or bequest.—In the case of property acquired by gift, bequest, devise or descent the basis for computing gain or loss on a sale is the fair market price or value of the property at the date of acquisition or as of March 1, 1913, if acquired prior thereto. For the purpose of determining the profit or loss from the sale of property acquired by bequest, devise or descent since February 28, 1913, its value as appraised for the purpose of the federal estate tax, or in the case of estates not subject to that tax its value as appraised in the State court for the purpose of State inheritance taxes, should be deemed to be its fair market value when acquired. See section 213 (b) (3) of the statute and article 73.

ART. 1563. Exchanges of property.—Gain or loss arising from the acquisition and subsequent disposition of property is realized when as the result of a transaction between the owner and another person the property is converted into cash or into property (a) that is essentially different from the property disposed of and (b) that has a market value. In other words, both (a) a change in substance and not merely in form, and (b) a change into the equivalent of cash, are required to complete or close a transaction from which income may be realized. By way of illustration, if a man owning ten shares of listed stock exchanges his stock certificate for a voting trust certificate, no income is realized, because the conversion is merely in form; or if he exchanges his stock for stock in a small, closely held corporation, no income is realized if the new stock has no market value, although the conversion is more than formal; but if he exchanges his stock for a liberty bond, income may be realized, because the conversion is into independent property having a market value. The property received in exchange may be real estate, personal property, or a chose in action. The exchange of a so-called convertible bond for stock pursuant to such a privilege granted in the bond will produce income if the stock received in exchange has a fair market value in excess of the cost or fair market value as of March 1, 1913, of the bond.

ART. 1564. Determination of gain or loss from exchange of property.—(a) The amount of income derived in the case of an exchange of property, as of stock for a bond, is the excess of the fair market value at the time of exchange of the bond received in exchange over the original cost of the stock exchanged for it, or over the fair market price or value of such stock as of March 1, 1913, if acquired before

that date. The amount of income derived from a subsequent sale of the bond for cash is the excess of the amount so received over the fair market value of such bond when acquired in exchange for the stock. (b) On the other hand, if the property received in exchange is substantially the same property or has no market value, then no gain or loss is realized, but the new property is to be regarded as substituted for the old and upon a sale of the new property the amount of income derived is the excess of the amount so received over the cost or fair market value as of March 1, 1913, of the old.

ART. 1565. Exchange for different kinds of property.—(a) If property is exchanged for two different kinds of property, such as bonds and stock, the bonds having a market value and the stock none, the value of the bonds is to be compared with the cost or fair market value as of March 1, 1913, of the original property, as the case may be. If the market value of the bonds is less than such cost or value, the difference represents the cost of the stock. If the market value of the bonds is greater than such cost or value, the difference is taxable income at the time of the exchange and whenever sold the entire proceeds of the stock will be taxable. (b) If property is exchanged for two different kinds of property, such as bonds and stock, neither having a market value, the cost or fair market value as of March 1, 1913, of the original property should be apportioned, if possible, between the bonds and stock for the purpose of determining gain or loss on subsequent sales. If no fair apportionment is practicable, no profit on any subsequent sale of any part of the bonds or stock is realized until out of the proceeds of sales shall have been recovered the entire cost or fair market value as of March 1, 1913, of the original property.

ART. 1566. Exchange of property and stock.—(a) Where property is transferred to a corporation in exchange for its stock, if the previous owner of the property receives 50 per cent or more of the stock of the corporation, so that an interest of 50 per cent or more in such property remains in him, then no gain or loss is realized by such owner from the transaction. For the purpose of ascertaining the gain or loss from the subsequent sale by the stockholder of any stock so received for such property the stock is to be considered as substituted for the property, and the cost of the property or (if acquired prior thereto) its fair market value as of March 1, 1913, is the basis for determining the amount of such gain or loss. For the purpose of ascertaining the gain or loss from the subsequent sale by the corporation of any such property the cost of the property to the former owner or (if acquired prior thereto by him) its fair market value as of March 1, 1913, is the basis for determining the amount of such gain or loss. As to the invested capital of the corporation, see section 331 of the statute and article 941. "Owner" includes "owners." This article applies to the incorporation of a business previously

conducted by an individual or by a partnership. (b) If, however, the exchange of property and stock involves less than 50 per cent of the stock of the corporation, the exchange constitutes a closed transaction, and the former owner of the property realizes a gain or loss if the stock has a market value and such market value is greater or less than the cost or (if acquired prior thereto) the fair market value as of March 1, 1913, of the property given in exchange. (c) Where a corporation dissolves and distributes its assets in kind and not in cash no taxable income is received from the transaction by its stockholders, because they merely exchange an indirect interest for a direct interest in the same property. As to cash distributions, see article 1548. For the purpose of ascertaining the gain or loss from the subsequent sale of any property so received upon dissolution see article 1564 (b). See also articles 542 and 547.

ART. 1567. Exchange of stock for other stock of no greater par value.—In general, where two (or more) corporations unite their properties by either (a) the dissolution of corporation B and the sale of its assets to corporation A, or (b) the sale of its property by B to A and the dissolution of B, or (c) the sale of the stock of B to A and the dissolution of B, or (d) the merger of B into A, or (e) the consolidation of the corporations, no taxable income is received from the transaction by A or B or the stockholders of either, provided the sole consideration received by B and its stockholders in (a), (b), (c) and (d) is stock or securities of A, and by A and B and their stockholders in (e) is stock or securities of the consolidated corporation, in any case of no greater aggregate par or face value than the old stock and securities surrendered. If the stock so received has no nominal or par value the limitation on aggregate par value is inapplicable.

ART. 1568. Determination of gain or loss from subsequent sale.—The new stock and securities received as described in the preceding article take the place of the old stock and securities. For the purpose, therefore, of ascertaining the gain derived or loss sustained from the subsequent sale of any stock of A or of the consolidated corporation so received, the original cost to the taxpayer or the fair market value as of March 1, 1913, of the stock of B or A in respect of which the new stock was issued, less any untaxed distribution made to the taxpayer by A out of the former capital or surplus of B, or by the consolidated corporation out of the former capital or surplus of A or B, is the basis for determining the amount of such gain or loss. Similarly, the cost after reorganization, merger or consolidation of the assets of A or of the consolidated corporation is the sum of the cost (or the fair market value as of March 1, 1913) of the assets of A and of B for the purpose of ascertaining the gain or loss upon a subsequent sale. The new invested capital of A or of the consolidated corporation is to

be determined as if A and B were rendering a consolidated return as affiliated corporations. See sections 240 and 326 of the statute and articles 631-638 and 864-869.

ART. 1569. Exchange of stock for other stock of greater par value.—If in the case of any reorganization, merger or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock and securities exchanged, income will be realized from the transaction by the recipients of the new stock or securities to an amount limited by (a) the excess of the par or face value of the new stock or securities over the par or face value of the old and (b) the excess of the fair market value of the new stock or securities over the cost or fair market value as of March 1, 1913, of the old. In other words, the taxable profit will be (a) or (b), whichever is less. Upon a subsequent sale of the new stock or securities their cost to the taxpayer will be the cost or fair market value as of March 1, 1913, of the old stock and securities, plus the profit taxed on the exchange.

ART. 1570. Readjustment of partnership interests.—When a partner retires from a partnership, or it is dissolved, he realizes a gain or loss measured by the difference between the price received for his interest and the cost to him or (if acquired prior thereto) the fair market value as of March 1, 1913, of his interest in the partnership, including in such cost or value the amount of his share in any undistributed partnership net income earned since February 28, 1913, on which the income tax has been paid. If, however, the partnership distributes its assets in kind and not in cash, the partner realizes no gain or loss until he disposes of the property received on distribution. See article 1566. Whenever a new partner is admitted to a partnership, or any existing partnership is reorganized, the facts as to such change or reorganization should be fully set forth in the next return of income, in order that the Commissioner may determine whether any gain or loss has been realized by any partner. See also article 1563.

INVENTORIES.

SEC. 203. That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

ART. 1581. Need of inventories.—In order to reflect the net income correctly, inventories at the beginning and ending of each year are necessary in every case in which the production, purchase or sale of merchandise is an income-producing factor. The inventory should include raw materials and supplies on hand that have been acquired for sale, consumption or use in productive processes, together with all finished or partly finished goods. Title to the merchandise in-

cluded in the inventory should be vested in the taxpayer and goods merely ordered for future delivery and for which no transfer of title has been effected should be excluded. The inventory should include merchandise sold but not shipped to the customer at the date of the inventory, together with any merchandise out upon consignment, but if such goods have been included in the sales of the taxable year they should not be taken in the inventory. It should also include merchandise purchased, although not actually received, to which title has passed to the purchaser. In this regard care should be exercised to take into the accounts all invoices or other charges in respect of merchandise properly included in the inventory, but which is in transit or for other reasons has not been reduced to physical possession.

ART. 1582. Valuation of inventories.—Inventories should be valued at (a) cost or (b) cost or market whichever is lower. Whichever basis is adopted must be applied to each item and not merely to the total of the inventory; that is, if for instance basis (b) is adopted, the value of each item in the inventory will be measured by market if that is lower than cost, or by cost if that is lower than market. A taxpayer may, regardless of his past practice, adopt the basis of cost or market, whichever is lower, for his 1918 inventory, provided a disclosure of the fact and that it represents a change is made in the return. Thereafter changes can be made only after permission is secured from the Commissioner. But see article 1585 for inventories by dealers in securities. Inventories should be recorded in a legible manner and properly computed and summarized, and should be preserved as a part of the accounting records of the taxpayer. Goods taken in the inventory which have been so intermingled that they can not be identified with specific invoices will be deemed to be the goods most recently purchased.

ART. 1583. Inventories at cost.—Cost means:

(1) In the case of merchandise purchased, the invoice price less trade or other discounts except strictly cash discounts approximating a fair interest rate, which may be deducted or not at the option of the taxpayer provided a consistent course is followed. To this net invoice price should be added transportation or other necessary charges incurred in acquiring possession of the goods.

(2) In the case of merchandise produced by the taxpayer, (a) the cost of raw materials and supplies entering into or consumed in connection with the product, (b) expenditures for direct labor, (c) indirect expenses incident to and necessary for the production of the particular article, including in such indirect expenses a reasonable proportion of management expenses, but not including any cost of selling or return on capital whether by way of interest or profit. In any industry in which the usual rules for computation of cost

of production are inapplicable, costs may be approximated upon such basis as may be reasonable and in conformity with established trade practice in the particular industry.

ART. 1584. Inventories at market.—Market means the current bid price prevailing at the date of the inventory for the particular merchandise, and is applicable to goods purchased and on hand and to basic materials 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 at fixed prices entered into before the date of the inventory. Where no open market quotations are available the taxpayer must use such evidence of a fair market price at the date or dates nearest the inventory as may be available to him, such as specific transactions in reasonable volume entered into in good faith, or compensation paid for cancellation of contracts for purchase commitments. The burden of proof will rest upon the taxpayer in each case to satisfy the Commissioner of the correctness of the prices adopted. It is recognized that in the latter part of 1918, by reason among other things of governmental control not having been relinquished, conditions were abnormal and in many commodities there was no such scale of trading as to establish a free market. In such a case, when a market has been established during the succeeding year, a claim may be filed for any loss sustained in accordance with the provisions of section 214 (a) (12) or section 234 (a) (14) of the statute. See articles 261–268.

ART. 1585. Inventories by dealers in securities.—A dealer in securities, who in his books of account regularly inventories unsold securities on hand either (a) at cost or (b) at cost or market value whichever is lower, may make his return upon the basis upon which his accounts are kept; provided that a description of the method employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years, unless another be authorized by the Commissioner. For the purpose of this rule a dealer in securities is a merchant of securities, whether an individual, partnership or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers, that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation, and not in the course of an established business, and officers of corporations and members of partnerships, who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule.

NET LOSSES.

SEC. 204. (a) That as used in this section the term "net loss" refers only to net losses resulting from either (1) the operation of any business regularly carried on by the taxpayer, or (2) the bona fide sale by the taxpayer of plant, buildings, machinery, equipment or other facilities, constructed, installed or acquired by the taxpayer on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war; and when so resulting means the excess of the deductions allowed by law (excluding in the case of corporations amounts allowed as a deduction under paragraph (6) of subdivision (a) of section 234) over the sum of the gross income plus any interest received free from taxation both under this title and under Title III.

(b) If for any taxable year beginning after October 31, 1918, and ending prior to January 1, 1920, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount of such net loss shall under regulations prescribed by the Commissioner with the approval of the Secretary be deducted from the net income of the taxpayer for the preceding taxable year; and the taxes imposed by this title and by Title III for such preceding taxable year shall be redetermined accordingly. Any amount found to be due to the taxpayer upon the basis of such redetermination shall be credited or refunded to the taxpayer in accordance with the provisions of section 252. If such net loss is in excess of the net income for such preceding taxable year, the amount of such excess shall under regulations prescribed by the Commissioner with the approval of the Secretary be allowed as a deduction in computing the net income for the succeeding taxable year.

(c) The benefit of this section shall be allowed to the members of a partnership and the beneficiaries of an estate or trust under regulations prescribed by the Commissioner with the approval of the Secretary.

ART. 1601. Scope of net losses.—As used in the statute the term "net loss" means either a business operating loss or a loss realized by a bona fide sale of property constructed, installed or acquired on or after April 6, 1917, for the production of articles contributing to the prosecution of the war. The amount of net loss claimed must represent an actual net loss over and above all income, including tax-free income. Such losses will be allowable only in respect of a taxpayer having a taxable year beginning after October 31, 1918, and ending prior to January 1, 1920, and after one claim has been allowed no further claim can be considered.

ART. 1602. Claim for allowance of net loss.—A taxpayer having such a net loss may file a claim on form 46 with his return of income for the taxable year 1919. Such claim should contain a concise statement setting forth the amount of the loss sustained, in accordance with the accompanying return, the nature of the loss, the amount of the taxpayer's net income for the taxable year 1918, the taxes paid by him with respect thereto, and all pertinent facts necessary to enable the Commissioner to determine the allowability of the claim.

ART. 1603. Allowance of net loss.—The amount allowed by the Commissioner in respect of any such claim shall be deducted from the net income for the taxable year 1918 and the income and the war profits and excess profits tax, if any, for such year shall be recomputed accordingly. Any amount found to be due him shall be credited or refunded to the taxpayer. See section 252 of the statute and articles 1034–1036. In any case in which it is found by the Commissioner that such net loss is in excess of the net income of such preceding taxable year, the taxpayer may carry forward the amount of such excess and claim it as a deduction in computing net income for the succeeding taxable year.

FISCAL YEAR WITH DIFFERENT RATES.

SEC. 205. (a) That if a taxpayer makes return for a fiscal year beginning in 1917 and ending in 1918, his tax under this title for the first taxable year shall be the sum of: (1) the same proportion of a tax for the entire period computed under Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917 and under Title I of the Revenue Act of 1917, which the portion of such period falling within the calendar year 1917 is of the entire period, and (2) the same proportion of a tax for the entire period computed under this title at the rates for the calendar year 1918 which the portion of such period falling within the calendar year 1918 is of the entire period: *Provided*, That in the case of a personal service corporation the amount to be paid shall be only that specified in clause (1).

Any amount heretofore or hereafter paid on account of the tax imposed for such fiscal year by Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917, and by Title I of the Revenue Act of 1917, shall be credited towards the payment of the tax imposed for such fiscal year by this Act, and if the amount so paid exceeds the amount of such tax imposed by this Act, or, in the case of a personal service corporation, the amount specified in clause (1), the excess shall be credited or refunded in accordance with the provisions of section 252.

(b) If a taxpayer makes a return for a fiscal year beginning in 1918 and ending in 1919, the tax under this title for such fiscal year shall be the sum of: (1) the same proportion of a tax for the entire period computed under this title at the rates specified for the calendar year 1918 which the portion of such period falling within the calendar year 1918 is of the entire period; and (2) the same proportion of a tax for the entire period computed under this title at the rates specified for the calendar year 1919 which the portion of such period falling within the calendar year 1919 is of the entire period.

(c) If a fiscal year of a partnership begins in 1917 and ends in 1918 or begins in 1918 and ends in 1919, then notwithstanding the provisions of subdivision (b) of section 218, (1) the rates for the calendar year during which such fiscal year begins shall apply to an amount of each partner's share of such partnership net income (determined under the law applicable to such year) equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year, and (2) the rates for the calendar year during which such fiscal year ends shall apply to an amount of each partner's share of

such partnership net income (determined under the law applicable to such calendar year) equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year: *Provided*, That in the case of a personal service corporation with respect to a fiscal year beginning in 1917 and ending in 1918, the amount specified in clause (1) shall not be subject to normal tax.

ART. 1621. Fiscal year with different rates.—Section 205 of the statute applies to income taxes. For the provisions with respect to war profits and excess profits taxes see section 335 and articles 951-955. Subdivision (a), which deals with fiscal years beginning in 1917 and ending in 1918, applies to corporations, including personal service corporations, and to individuals. Subdivision (b), which deals with fiscal years beginning in 1918 and ending in 1919, applies to corporations other than personal service corporations and to individuals. Subdivision (c), which deals with fiscal years beginning in 1917 or 1918 and ending in 1918 or 1919, applies to partnerships and to personal service corporations. See as to partnerships articles 321-327, and as to personal service corporations articles 328-335.

ART. 1622. Fiscal year of corporation ending in 1918.—The method provided for computing the tax for a fiscal year beginning in 1917 and ending in 1918 is as follows: (a) the tax attributable to the calendar year 1917 is found by computing the income of the taxpayer and the tax thereon in accordance with Title I of the Revenue Act of 1916 as amended and Title I of the Revenue Act of 1917 as if the fiscal year was the calendar year 1917, and determining the proportion of such tax which the proportion of the fiscal year falling within the calendar year 1917 is of the full fiscal year; (b) the tax attributable to the calendar year 1918 is found by computing the income of the taxpayer and the tax thereon in accordance with the present statute as if the fiscal year was the calendar year 1918, and determining the proportion of such tax which the portion of such fiscal year falling within the calendar year is of the full fiscal year; and (c) the tax for the fiscal year is found by adding the tax attributable to the calendar year 1917 and the tax attributable to the calendar year 1918. If a corporation made its return for the taxable year 1917 on the calendar year basis and for the taxable year 1918 on a fiscal year basis, the tax attributable to the calendar year 1917 need not again be computed and the tax attributable to the calendar year 1918 computed as herein provided shall be the tax of the corporation for the portion of such fiscal year falling within the calendar year 1918. A personal service corporation is not required to pay the tax attributable to the calendar year 1918, since for that year it is treated substantially like a partnership for the purposes of taxation. See section 218 of the statute and articles 328-335.

ART. 1623. Deductions and credits in the case of corporation fiscal year ending in 1918.—Net losses deductible from net income of the fiscal

year under the provisions of section 204 of the statute shall be deducted in computing the tax attributable to the calendar year 1917, as well as in computing the tax attributable to the calendar year 1918. In computing the tax attributable to the calendar year 1917 the net income computed for the entire period under Title I of the Revenue Act of 1916 as amended and Title I of the Revenue Act of 1917 shall be credited with the excess profits tax computed for the entire period under Title II of the Revenue Act of 1917. In computing the tax attributable to the calendar year 1918 the net income computed for the entire period under the present statute shall be credited with the war profits and excess profits tax computed for the entire period under Title III of the statute at the rates prescribed for 1918. See section 236 of the statute and article 591. Amounts previously paid by the taxpayer on account of the income tax for such fiscal year shall be credited towards the payment of the income tax imposed for such fiscal year by the present statute. Any excess shall be credited or refunded in accordance with the provisions of section 252. See articles 1031 and 1034-1036.

ART. 1624. Fiscal year of individual ending in 1918.—Since under the law applicable to the calendar year 1917 individuals were not permitted to make returns on the fiscal year basis (see Title I of the Revenue Act of 1916 as amended), the tax of an individual for that part of a fiscal year ending in 1918 attributable to the calendar year 1917 has already been included in the tax for such calendar year and need not ordinarily again be computed. The tax for that part of the year attributable to the calendar year 1918 is found by computing the income of the taxpayer for the taxable year and the tax thereon in accordance with the present statute as if the taxable year was the calendar year 1918, and determining the proportion of such tax which the portion of such fiscal year falling within the calendar year is of the full fiscal year.

ART. 1625. Fiscal year of corporation or individual ending in 1919.—The method provided for computing the tax for a fiscal year beginning in 1918 and ending in 1919 is as follows: (a) the tax attributable to the calendar year 1918 is found by computing the income of the taxpayer and the tax thereon in accordance with the statute as if the fiscal year was the calendar year 1918, and determining the proportion of such tax which the portion of such fiscal year falling within the calendar year is of the full fiscal year; (b) the tax attributable to the calendar year 1919 is found by computing the income of the taxpayer and the tax thereon in accordance with the statute as if the fiscal year was the calendar year 1919, and determining the proportion of such tax which the portion of such fiscal year falling within the calendar year is of the full fiscal year; and (c) the tax for the fiscal year is found by adding the tax attributable to the calendar year 1918 and the tax attributable to the calendar year 1919.

PARTS OF INCOME SUBJECT TO RATES FOR DIFFERENT YEARS.

SEC. 206. That whenever parts of a taxpayer's income are subject to rates for different calendar years, the part subject to the rates for the most recent calendar year shall be placed in the lower brackets of the rate schedule provided in this title, the part subject to the rates for the next preceding calendar year shall be placed in the next higher brackets of the rate schedule applicable to that year, and so on until the entire net income has been accounted for. In determining the income, any deductions, exemptions or credits of a kind not plainly and properly chargeable against the income taxable at rates for a preceding year shall first be applied against the income subject to rates for the most recent calendar year; but any balance thereof shall be applied against the income subject to the rates of the next preceding year or years until fully allowed.

ART. 1641. Parts of income subject to rates for different years.—Section 206 of the statute applies to a partner's share of partnership net income; to a stockholder's share of the net income of a personal service corporation; and to stock dividends received by a taxpayer between January 1 and November 1, 1918, or declared during that period and received by the taxpayer after November 1, 1918, and before March 27, 1919. For the treatment of income of a partner or of a stockholder in a personal service corporation see sections 218 and 205 of the statutes and articles 321-335, 1621 and 1624. For the treatment of stock dividends see section 201 and articles 1546 and 1642.

ART. 1642. Stock dividend subject to rates for different years.—The method of ascertaining the precise rate applicable to such portions of stock dividends received or credited in 1918 as are taxable at rates prescribed for previous years is as follows: The amount of the income of the recipient to which the 1918 rates are applicable is first ascertained. To such amount is then added the amount of income of the recipient liable to tax at the 1917 rates and the table of 1917 rates applied to see in which brackets such income falls. The income liable to 1916 rates is then added and the table of 1916 rates applied to it. For instance, an individual has \$20,000 of income liable to 1918 rates and \$25,000 of dividends liable to 1917 rates. The total would be \$45,000, of which \$20,000 would be taxable at the 1918 rates and \$20,000 to \$45,000 at the surtax rates under the 1917 table applying to income over \$20,000. In order that the correctness of the rates may be verified, taxpayers reporting stock dividends at other than 1918 rates will be required to render a statement at the time of filing their returns showing the corporations from which dividends taking other than 1918 rates were received, with the particulars of the dividends received from each. See also article 1546.

ADVISORY TAX BOARD.

Sec. 1301. (d) (1) There is hereby created a Board to be known as the "Advisory Tax Board," hereinafter called the Board, and to be composed of not to exceed six members to be appointed by the Commissioner with the approval of the Secretary. The Board shall cease to exist at the expiration of two years after the passage of this Act, or at such earlier time as the Commissioner with the approval of the Secretary may designate.

Vacancies in the membership of the Board shall be filled in the same manner as an original appointment. Any member shall be subject to removal by the Commissioner with the approval of the Secretary. The Commissioner with the approval of the Secretary shall designate the chairman of the Board. Each member shall receive an annual salary of \$9,000, payable monthly, together with actual necessary expenses when absent from the District of Columbia on official business.

(2) The Commissioner may, and on the request of any taxpayer directly interested shall, submit to the Board any question relating to the interpretation or administration of the income, war-profits or excess-profits tax laws, and the Board shall report its findings and recommendations to the Commissioner.

(3) The Board shall have its office in the Bureau of Internal Revenue in the District of Columbia. The expenses and salaries of members of the Board shall be audited, allowed, and paid out of appropriations for collecting internal revenue, in the same manner as expenses and salaries of employees of the Bureau of Internal Revenue are audited, allowed, and paid.

(4) The Board shall have the power to summon witnesses, take testimony, administer oaths, and to require any person to produce books, papers, documents, or other data relating to any matter under investigation by the Board. Any member of the Board may sign subpoenas and members and employees of the Bureau of Internal Revenue designated to assist the Board, when authorized by the Board, may administer oaths, examine witnesses, take testimony and receive evidence.

ART. 1701. Submission of questions to Advisory Tax Board.—Questions relating to the interpretation or administration of the income tax and war profits and excess profits tax laws may be submitted to the Advisory Tax Board by the Commissioner on his own initiative or at the request of any taxpayer directly interested for the purpose of obtaining the recommendation of the Board thereon. When a final conclusion has been reached by the income tax unit of the Internal Revenue Bureau as to the disposition of a matter, any taxpayer directly interested therein may request the Commissioner to submit such matter to the Board. In the case of matters arising in connection with the audit of a taxpayer's return the taxpayer will ordinarily be notified of such conclusion prior to assessment by letter. The taxpayer shall file with the Commissioner (to be transmitted to the income tax unit) a request in writing for submission with a statement

of his objections to the conclusion of the unit and the reasons for such objections. Such request and statement shall be filed with the Commissioner within thirty days after the taxpayer has been notified of the conclusion of the income tax unit or within such longer period as the Commissioner may allow, but the Board may at its discretion at any time receive additional statements of objections or reasons therefor.

ART. 1702. Procedure before Advisory Tax Board.—Matters submitted to the Advisory Tax Board will ordinarily be considered upon the papers, but a hearing for oral presentation of a case will be granted whenever the Board deems such hearing necessary for the proper disposition thereof. Matters will ordinarily be considered upon the facts presented to the income tax unit. New evidence will not ordinarily be received by the Board, but matters will be recommitted to the income tax unit for further presentation of facts. Oral or written evidence may, however, be received by the Board whenever it deems such action necessary for the protection of the Government or the prevention of injustice to the taxpayer. Decisions by the Board upon matters referred to it at the request of taxpayers will be transmitted to the Commissioner.

EXTENSION OF EXISTING STATUTES.

SEC. 1305. That all administrative, special, or stamp provisions of law, including the law relating to the assessment of taxes, so far as applicable, are hereby extended to and made a part of this Act, and every person liable to any tax imposed by this Act, or for the collection thereof, shall keep such records and render, under oath, such statements and returns, and shall comply with such regulations as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

Whenever in the judgment of the Commissioner necessary he may require any person, by notice served upon him, to make a return or such statements as he deems sufficient to show whether or not such person is liable to tax.

The Commissioner, for the purpose of ascertaining the correctness of any return or for the purpose of making a return where none has been made, is hereby authorized, by any revenue agent or inspector designated by him for that purpose, to examine any books, papers, records or memoranda bearing upon the matters required to be included in the return, and may require the attendance of the person rendering the return or of any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take his testimony with reference to the matter required by law to be included in such return, with power to administer oaths to such person or persons.

ART. 1711. Aids to collection of tax.—In collecting the income and war profits and excess profits taxes the Commissioner has the benefit of all existing internal revenue laws. In aid of the enforcement of

the statute the Commissioner may require any person to keep specified records, to render returns and statements as directed, to submit himself and his books to examination, and to comply with such regulations as may be prescribed. Section 3165 of the Revised Statutes, as amended by section 1317 of the Revenue Act of 1918, provides:

SEC. 3165. Every collector, deputy collector, internal-revenue agent, and internal-revenue officer assigned to duty under an internal-revenue agent, is authorized to administer oaths and to take evidence touching any part of the administration of the internal-revenue laws with which he is charged, or where such oaths and evidence are authorized by law or regulation authorized by law to be taken.

See also sections 228, 250 and 1318 of the statute and articles 451 and 1002.

FRACTIONAL PART OF CENT.

SEC. 1313. That in the payment of any tax under this Act not payable by stamp a fractional part of a cent shall be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to 1 cent.

ART. 1721. When fractional part of cent may be disregarded.—In the payment of income or war profits and excess profits taxes, and in each step or computation necessary in determining the amount of any such tax, a fractional part of a cent may be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to one cent.

MEDIUM OF PAYMENT OF TAX.

SEC. 1314. That collectors may receive, at par with an adjustment for accrued interest, certificates of indebtedness issued by the United States and uncertified checks in payment of income, war-profits and excess-profits taxes and any other taxes payable other than by stamp, during such time and under such regulations as the Commissioner, with the approval of the Secretary, shall prescribe; but if a check so received is not paid by the bank on which it is drawn the person by whom such check has been tendered shall remain liable for the payment of the tax and for all legal penalties and additions the same as if such check had not been tendered.

ART. 1731. Payment of tax by certificates of indebtedness.—Collectors will receive at par United States Treasury certificates of indebtedness of the tax series of 1919, dated August 20, 1918, and maturing July 15, 1919, and of series T, dated November 7, 1918, and maturing March 15, 1919, in payment of income and war profits and excess profits taxes payable at or before the maturity of the certificates, and certificates of series T 2, having no coupon, dated January 16, 1919, and maturing June 17, 1919, in payment of taxes payable within sixty days before the maturity of the certificates. The terms of the accept-

ance of certificates of other issues will be prescribed from time to time. The amount at par of the certificates of indebtedness presented by any taxpayer in payment of taxes must not exceed the amount of the taxes to be paid by him.

ART. 1732. Procedure with respect to certificates of indebtedness.—Such certificates of indebtedness may be accepted by the collector prior to the date the tax is due and in that case should be forwarded by the collector to the federal reserve bank to be held for his account until the date the tax is due and for deposit on such date. All coupons maturing on or before the date the tax is due must be detached by the taxpayer and collected in ordinary course, but all other coupons must remain attached to the certificate and be forwarded to the federal reserve bank. Any accrued interest to the date the tax is due, not covered by coupons detached as above provided, will be remitted to the taxpayer by the federal reserve bank by check, for which purpose the collector will furnish to the bank the name and address of the taxpayer, the amount and serial numbers of the certificates presented in each case, the date of issue of the certificates, and the date the tax is due. Collectors shall in no case pay interest on such certificates nor accept them for an amount other or greater than their face value. Receipts given by collectors to taxpayers should show the amount of certificates of each series received in payment of taxes.* For the purpose of saving taxpayers the expense of transmitting such certificates as are held in federal reserve cities to the office of the collector in whose district the taxes are payable, taxpayers desiring to pay taxes by acceptable certificates of indebtedness should communicate with the collector and request from him authority to deposit such certificates to his credit with the federal reserve bank in the city in which the certificates are held.

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 remit-

tance; (e) the amount of the payment on account of each person; and (f) the kind of tax paid.

ARR. 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 DISTRICT COURTS.

SEC. 1318. That if any person is summoned under this Act to appear, to testify, or to produce books, papers or other data, the district court of the United States for the district in which such person resides shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, or other data.

The district courts of the United States at the instance of the United States are hereby invested with such jurisdiction to make and issue, both in actions at law and suits in equity, writs and orders of injunction, and of ne exeat republica, orders appointing receivers, and such other orders and process, and to render such judgments and decrees, granting in proper cases both legal and equitable relief together, as may be necessary or appropriate for the enforcement of the provisions of this Act. The remedies hereby provided are in addition to and not exclusive of any and all other remedies of the United States in such courts or otherwise to enforce such provisions.

DEPOSIT OF UNITED STATES BONDS AS SECURITY.

SEC. 1320. That wherever by the laws of the United States or regulations made pursuant thereto, any person is required to furnish any recognizance, stipulation, bond, guaranty, or undertaking, hereinafter called "penal bond," with surety or sureties, such person may, in lieu of such surety or sureties, deposit as security with the official having authority to approve such penal bond, United States Liberty bonds or other bonds of the United States in a sum equal at their par value to the amount of such penal bond required to be furnished, together with an agreement authorizing such official to collect or sell such bonds so deposited in case of any default in the performance of any of the conditions or stipulations of such penal bond. The acceptance of such United States bonds in lieu of surety or sureties required by law shall have the same force and effect as individual or corporate sureties, or

certified checks, bank drafts, post-office money orders, or cash, for the penalty or amount of such penal bond. The bonds deposited hereunder, and such other United States bonds as may be substituted therefor from time to time as such security, may be deposited with the Treasurer, or an Assistant Treasurer of the United States, a Government depository, Federal Reserve bank, or member bank, which shall issue receipt therefor, describing such bonds so deposited. As soon as security for the performance of such penal bond is no longer necessary, such bonds so deposited, shall be returned to the depositor: *Provided*, That in case a person or persons supplying a contractor with labor or material as provided by the Act of Congress, approved February 24, 1905 (33 Stat., 811), entitled "An Act to amend an Act approved August thirteenth, eighteen hundred and ninety-four, entitled 'An Act for the protection of persons furnishing materials and labor for the construction of public works,'" shall file with the obligee, at any time after a default in the performance of any contract subject to said Acts, the application and affidavit therein provided, the obligee shall not deliver to the obligor the deposited bonds nor any surplus proceeds thereof until the expiration of the time limited by said Acts for the institution of suit by such person or persons, and, in case suit shall be instituted within such time, shall hold said bonds or proceeds subject to the order of the court having jurisdiction thereof: *Provided further*, That nothing herein contained shall affect or impair the priority of the claim of the United States against the bonds deposited or any right or remedy granted by said Acts or by this section to the United States for default upon any obligation of said penal bond; *Provided further*, That all laws inconsistent with this section are hereby so modified as to conform to the provisions hereof: *And provided further*, That nothing contained herein shall affect the authority of courts over the security, where such bonds are taken as security in judicial proceedings, or the authority of any administrative officer of the United States to receive United States bonds for security in cases authorized by existing laws. The Secretary may prescribe rules and regulations necessary and proper for carrying this section into effect.

REPEAL OF FORMER ACTS.

Sec. 1400. (a) That the following parts of Acts are hereby repealed, subject to the limitations provided in subdivision (b) :

(1) The following titles of the Revenue Act of 1916:

- Title I (called "Income Tax");
- Title II (called "Estate Tax");
- Title III (called "Munitions Manufacturers' Tax"), as amended;
- Title IV (called "Miscellaneous Taxes").

(2) The following parts of the Act entitled "An Act to provide increased revenue to defray the expenses of the increased appropriations for the Army and Navy and the extensions of fortifications, and for other purposes," approved March 3, 1917:

- Title III (called "Estate Tax");
- Section 402 (called "Returns of Dividends").

(3) The following titles of the Revenue Act of 1917:

- Title I (called "War Income Tax");
- Title II (called "War Excess-Profits Tax");
- Title III (called "War Tax on Beverages");

Title IV (called "War Tax on Cigars, Tobacco, and Manufactures Thereof");

Title V (called "War Tax on Facilities Furnished by Public Utilities, and Insurance");

Title VI (called "War Excise Taxes");

Title VII (called "War Tax on Admissions and Dues");

Title VIII (called "War-Stamp Taxes");

Title IX (called "War Estate Tax");

Title X (called "Administrative Provisions");

Title XII (called "Income-Tax Amendments").

(b) Such parts of Acts shall remain in force for the assessment and collection of all taxes which have accrued thereunder, and for the imposition and collection of all penalties or forfeitures which have accrued and may accrue in relation to any such taxes, and except that the unexpended balance of any appropriation heretofore made and now available for the administration of any such part of an Act shall be available for the administration of this Act or the corresponding provision thereof: *Provided*, That, except as otherwise provided in this Act, no taxes shall be collected under Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917, or Title I or II of the Revenue Act of 1917, in respect to any period after December 31, 1917: *Provided further*, That the assessment and collection of all estate taxes, and the imposition and collection of all penalties or forfeitures, which have accrued under Title II of the Revenue Act of 1916 as amended by the Act entitled "An Act to provide increased revenue to defray the expenses of the increased appropriations for the Army and Navy and the extensions of fortifications, and for other purposes," approved March 3, 1917, or Title IX of the Revenue Act of 1917, shall be according to the provisions of Title IV of this Act. In the case of any tax imposed by any part of an Act herein repealed, if there is a tax imposed by this Act in lieu thereof, the provision imposing such tax shall remain in force until the corresponding tax under this Act takes effect under the provisions of this Act.

Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917 shall remain in force for the assessment and collection of the income tax in Porto Rico and the Philippine Islands, except as may be otherwise provided by their respective legislatures.

VALIDATING PROVISION.

Sec. 1402. That if any clause, sentence, paragraph, or part of this Act shall for any reason be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder of this Act, but shall be confined in its operation to the clause, sentence, paragraph, or part thereof directly involved in the controversy in which such judgment has been rendered.

CITATION OF ACT.

Sec. 1405. That this Act may be cited as the "Revenue Act of 1918."

INSPECTION OF GOVERNMENT CONTRACTS.

Sec. 1408. That every person who on or after April 6, 1917, entered into any contract, undertaking, or agreement with the United States,

or with any department, bureau, officer, commission, board, or agency under the United States or acting in its behalf, or with any other person having contract relations with the United States, for the performance of any work or the supplying of any materials or property for the use of or for the account of the United States, shall, within thirty days after a request of the Commissioner therefor, file with the Commissioner a true and correct copy of every such contract, undertaking, or agreement.

Whoever fails to comply with such request of the Commissioner shall be guilty of a misdemeanor and shall be punished by a fine of not more than \$1,000, or by imprisonment for not more than one year, or both.

The Commissioner shall (when not violative of the technical military or naval secrets of the Government) have access to all information and data relating to any such contract, undertaking or agreement, in the possession, control or custody of any department, bureau, board, agency, officer or commission of the United States and may call upon any such department, bureau, board, agency, officer or commission for a full statement and description of any allowance for amortization, obsolescence, depreciation or loss, or of any valuation, appraisal, adjustment or final settlement, made in pursuance of any such contract, undertaking, or agreement.

AUTHORITY FOR REGULATIONS.

SEC. 1309. That the Commissioner, with the approval of the Secretary, is hereby authorized to make all needful rules and regulations for the enforcement of the provisions of this Act.

ART. 1800. Promulgation of regulations.—In pursuance of the statute the foregoing regulations are hereby made and promulgated and all rulings inconsistent herewith are hereby revoked.

DANIEL C. ROPER,
Commissioner of Internal Revenue.

Approved April 16, 1919:

CARTER GLASS,
Secretary of the Treasury.