The President

EXECUTIVE ORDER 9388

Possession and Operation of Coal Mines

WHEREAS widespread stoppages have occurred in the coal industry and strikes are threatened which will obstruct the effective prosecution of the war by curtailing vitally needed production in the coal mines directly affecting the war, and to do all things necessary to provide protection to all such persons and mines.

The Secretary of the Interior shall authorize and direct to maintain customary working conditions in the mines and custom and procedure for the adjustment of workers' grievances. He shall recognize the right of the workers to continue their membership in any labor organization, to bargain collectively through representatives of their own choosing, and to engage in concerted activities do interfere with the operation of the mines.

The Secretary of the Interior is further authorized and directed to offer to the duly constituted representatives of the workers' own choosing a contract or contracts governing the terms and conditions of employment for the period of the operation of the mines by the Government, in accordance with the opinion of the National War Labor Board in the matter of Illinois Coal Operators Association and United Mine Workers of America of October 26, 1943, and with such further directives as may be given by the War Labor Board. When any such contract has been agreed upon, the Secretary of the Interior shall apply under section 5 of the War Labor Disputes Act to the National War Labor Board for the approval of such contract and such changes in the terms and conditions of employment as may be authorized therein.

Possession and operation of any mine or mines hereunder shall be terminated by the Secretary of the Interior as soon as he determines that production and operation hereunder are no longer required for the furtherance of the war program, but in no event more than sixty (Continued on next page)
TITLE 26—INTERNAL REVENUE
Chapter I—Bureau of Internal Revenue
Subchapter A—Income and Excess-Profit Taxes

(Regulations 111)

PART 29—INCOME TAX: TAXABLE YEARS
BEGINNING AFTER DECEMBER 31, 1941

Explanations of Regulations—Scope. The main body of the regulations deals with the income taxes imposed by chapter 1 (sections 1 to 476, inclusive) and subchapter A of chapter 2 (sections 500 to 511, inclusive) of the Internal Revenue Code, and with sections 3777 (definitions) and 3801 (mitigation of effect of limitation and other provisions) thereof. The regulations are applicable only with respect to taxable years beginning after December 31, 1941.

Arrangement and numbering: Each section, subsection, or paragraph of the Internal Revenue Code set forth in the regulations is followed by the section or subsection, or paragraph of the Internal Revenue Code which the regulations interpret. Where sections of the Code may readily be distinguished from sections of the regulations, each of the latter appears in larger type and bears a number corresponding with the income taxes imposed by chapters (defining) and subsections or paragraphs (interpreted) of the chapters. Thus, one can readily ascertain how the regulations sections are necessary in the interpretation of different phases of the Code. For example, section 23 (m) of the Code, dealing with "Depletion," requires many regulations sections. Each of them, however, is designated by the key § 29.23 (m) (1), for example, § 29.23 (m) (1), § 29.23 (m) (2), etc.

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29.258-1 Time and place of filing returns.

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tions, and with the surtax imposed by subchapter A of chapter 2 (sections 500 to 511, inclusive) upon the undistributed subchapter A net income of personal holding companies.

These provisions are applicable only with respect to taxable years beginning after December 31, 1941.

Each section, subsection, or paragraph of the Internal Revenue Code set forth in these regulations, is divided into six subparts. Subpart A relates to introductory provisions, Subpart B—General provisions, divided into parts and sections. Subpart C—Supplemental provisions divided into parts and sections. Subpart D—Victory tax on individuals, divided into parts and sections.

§ 29.3-1 Division of regulations. These regulations, which constitute Part 29 of Title 26 of the 1943 Supplement to the Code of Federal Regulations, are divided into six subparts. Subpart A relates to introductory provisions. Subpart B relates to general provisions. Subpart C relates to supplemental provisions. Subpart D relates to victory tax on individuals. Subpart E relates to surtax on personal holding companies. Subpart F relates to definitions. Subpart G relates to mitigation of effect of limitation and other provisions in income tax cases.

§ 29.4-1 Application of regulations to special classes of taxpayers. With respect to certain classes of taxpayers, the application of the provisions of Subpart B of these regulations is subject to certain exceptions and additional provisions which appear in Subpart C, as follows:

Estates and trusts—sections 161 to 172, inclusive.

Partnerships—sections 181 to 190, inclusive.

Insurance companies—sections 201 to 207, inclusive.

Foreign corporations—sections 213 to 237, inclusive.

Income from sources in possessions of the United States—sections 251 and 252.

China Trade Act corporations—sections 251 to 258, inclusive.

Foreign personal holding companies—sections 271 to 280, inclusive.

Regulated investment companies—sections 281 and 282.

Shareholders of personal service corporations—sections 291 to 296, inclusive.

Individuals with gross income from certain sources or less—sections 300 to 304, inclusive.

SUBPART B—GENERAL PROVISIONS

§ 29.11-1 Income tax on individuals. Chapter 1 of the Internal Revenue Code imposes an income tax on individuals, including a normal tax (section 11a), a surtax (section 12), and a victory tax (section 450). For optional tax in the case of taxpayers filing gross income from certain sources over $3,000, see section 400. The normal tax on individuals is at the rate of 6 percent and is upon net income, which is determined by subtracting the allowable deductions from the gross income. See generally sections 21 to 24, inclusive. In certain cases credits are allowed against the net income before computing the tax (section 23) and in other cases against the amount of the tax (sections 31, 32, and 131). In general, the tax is payable upon the basis of returns rendered by persons liable therefor (sections 51, 53, and 117), and in some instances it is to be paid at the source of the income. Exceptions and additional provisions applicable to certain special classes of taxpayer are listed in section 4.

See Supplement P (sections 331 to 340, inclusive) as to shareholders of personal holding companies. See section 117 as to the treatment of capital gains and capital losses.

§ 29.11-2 Citizens or residents of the United States liable to tax. In general, citizens of the United States, wherever resident, are liable to the tax, and it makes no difference that they may own no assets within the United States and may receive no income from sources within the United States. Every resident alien individual is liable to the tax even though his income is wholly from sources outside the United States. As to nonresident alien individuals, see sections 211 to 219, inclusive.

§ 29.11-3 Who is a citizen. Every person born or naturalized in the United States, and subject to its jurisdiction, is a citizen. When any naturalized citizen has left the United States and resided for two years in the foreign country from which he came, or for five years in any other foreign country, it is presumed that he has ceased to be an American citizen. This presumption does not apply, however, to residence abroad while the United States is at war, nor does it apply in the case of individuals born in the United States subject to its jurisdiction. However, even though an individual born in the United States, subject to its jurisdiction, of either citizen or alien parents, residing in a foreign country for a number of years, he would still be a citizen of the United States, unless he had become naturalized in, or taken an oath of allegiance to, the foreign country of residence or some other foreign state. A foreigner who has filed his declaration of intention of becoming a citizen of the United States but who has not yet received the necessary papers from the United States is a citizen. See §§ 29.211-2 to 29.211-5, inclusive, for distinction between a resident alien individual and a nonresident alien individual.

Sec. 12. Surtax on individuals. [As amended by secs. 163, 164 (J), Rev. Act 1941; secs. 163, 165 (J), Rev. Act 1921.] (a) Definition of "surtax net income". As used in this section the term "surtax net income" means the amount of the net income in excess of the credits against net income provided in section 25 (b).

(b) Rates of surtax. There shall be levied, collected, and paid for each taxable year upon the surtax net income of an individual the surtax shown in the following table:

If the surtax net income is: The surtax shall be:

Not over $2,000.00 .................................................. 15% of the surtax net income.

Over $2,000 but not over $4,000.00 ............................. $200, plus 16% of excess over $2,000.00.

Over $4,000 but not over $6,000.00 ............................. $250, plus 19% of excess over $4,000.00.

Over $6,000 but not over $8,000.00 ............................. $325, plus 22% of excess over $6,000.00.

Over $8,000 but not over $10,000.00 ........................... $425, plus 25% of excess over $8,000.00.

Over $10,000 but not over $12,000.00 ........................... $550, plus 28% of excess over $10,000.00.

Over $12,000 but not over $14,000.00 ........................... $695, plus 31% of excess over $12,000.00.

Over $14,000 but not over $16,000.00 ........................... $850, plus 34% of excess over $14,000.00.

Over $16,000 but not over $18,000.00 ........................... $1,025, plus 37% of excess over $16,000.00.

Over $18,000 but not over $20,000.00 ........................... $1,225, plus 40% of excess over $18,000.00.

Over $20,000 but not over $22,000.00 ........................... $1,450, plus 43% of excess over $20,000.00.

Over $22,000 but not over $25,000.00 ........................... $1,700, plus 46% of excess over $22,000.00.

Over $25,000 but not over $30,000.00 ........................... $2,050, plus 50% of excess over $25,000.00.

Over $30,000 but not over $35,000.00 ........................... $2,550, plus 55% of excess over $30,000.00.

Over $35,000 but not over $40,000.00 ........................... $3,150, plus 60% of excess over $35,000.00.

Over $40,000 but not over $45,000.00 ........................... $3,800, plus 65% of excess over $40,000.00.

Over $45,000 but not over $50,000.00 ........................... $4,600, plus 70% of excess over $45,000.00.

Over $50,000 but not over $55,000.00 ........................... $5,500, plus 75% of excess over $50,000.00.
The surtax for any amount of surtax net income not stated in round figures in the table is computed by adding to the surtax for the largest amount stated which is less than the surtax net income, the surtax on 511, exclusive. For surtax on corporations in general the normal-tax net income minus the credit provided in section 26 (e) relating to interest on certain obligations of the United States and its instrumentalities, the tax imposed by section 13 is payable upon the basis of returns rendered by the corporations liable thereto, except that in some cases a tax is to be paid at the source of the income (see also sections 47, 52, 144, and 235).

The tax imposed by section 13 depends upon the amount of the corporation's normal-tax net income. If the normal-tax net income is more than $50,000, the tax is 24 per centum of the normal-tax net income in excess of $50,000. If the normal-tax net income is more than $25,000 and not more than $50,000, the tax is $4,250 plus 31 per cent of the amount in excess of $25,000.

This section may be illustrated by the following examples:

Example (1). The A Corporation, a domestic corporation, which is not a bank allied to its parent for purposes of computing the tax imposed by section 13 depends upon the amount of the corporation's normal-tax net income. If the normal-tax net income is more than $150,000, including interest on United States obligations (allowable as a credit under section 26 (a)), in the amount of $10,000 and dividends received (allowable as a credit under section 26 (a)) in the amount of $30,000, the A Corporation's normal-tax net income is $150,000. The corporation's tax under section 13 for the calendar year 1942 is $21,000, computed as follows:

<table>
<thead>
<tr>
<th>Net Income</th>
<th>Tax (24%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 to $50,000</td>
<td>$0</td>
</tr>
<tr>
<td>$50,001 to $100,000</td>
<td>$12,000</td>
</tr>
<tr>
<td>$100,001 to $150,000</td>
<td>$21,000</td>
</tr>
</tbody>
</table>

Less credit for interest on United States obligations $10,000

Adjusted net income $120,000

(c) Tax in case of capital gains or losses. For rate and computation of alternative tax for sale of capital assets held for more than six months, see section 117 (e).

d) Sale of oil or gas properties. For limitation of surtax attributable to the sale of oil or gas properties, see section 105.

(e) Tax on personal holding companies. For surtax on personal holding companies, see section 609.

(1) Avoidance of surtaxes by incorporation. For surtax on corporations which accumulate surplus to avoid surtax on shareholders, see section 102.

(2) For alternative tax if gross income from certain sources is $5,000 or less, see section 400.

§ 29.12-1 Surtax. In addition to the normal tax imposed by section 11 a surtax is imposed at the rates specified in section 12 upon the surtax net income of every individual, resident or nonresident, except nonresident alien individuals subject to the tax imposed by section 211 (a). The surtax net income is the amount of the net income in excess of the personal exemption and credit for dependents. For surtax on corporations improperly accumulating surplus, see section 102. As to surtax on personal holding companies, see sections 500 to 511, inclusive.

§ 29.12-2 Computation of surtax. The following table shows the surtax due for taxable years beginning after December 31, 1941, upon certain specified amounts of surtax net income. In each instance the first figure of the surtax net income in the surtax net-income column is to be excluded and the second figure included. The percentage given opposite applies to the excess income over the first figure in the surtax net-income column. The last column gives the total surtax on a surtax net income equal to the second figure in the surtax net-income column.

### Surtax Table

<table>
<thead>
<tr>
<th>Surtax net income</th>
<th>Percent</th>
<th>Total surtax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$9 to $20,000</td>
<td>13%</td>
<td>$2,600</td>
</tr>
<tr>
<td>$20,001 to $40,000</td>
<td>20%</td>
<td>$4,000</td>
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<td>$2,000,001 up</td>
<td>75%</td>
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Section 14. Tax on special classes of corporations [as amended by sec. 201, Rev. Act 1939].

(a) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(b) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement G (see section 261 and 332).

(c) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(d) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(e) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(f) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(g) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(h) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(i) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(j) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(k) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(l) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(m) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(n) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(o) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(p) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(q) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(r) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(s) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(t) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(u) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(v) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(w) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(x) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(y) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).

(z) For corporations not engaged in trade or business within the United States, the tax shall be as provided in Supplement Q (see section 261 and 332).
(3) Surtax net incomes over $50,000.
Upon corporation surtax net incomes over $50,000, 16 percent of the amount thereof.

§ 29.15-1 Surtax on corporations. Section 15 imposes a surtax upon the corporation surtax net income of every corporation, except (1) Western Hemisphere trade corporation (see Supplement Q), (2) foreign corporations taxable under section 231 (a), (3) insurance companies (see Supplement G (sections 261 to 267, inclusive)), or (4) regulated investment companies (see Supplement Q (sections 261 and 262)).

The "corporation surtax net income" of a corporation is its net income minus (1) the credit provided in section 25 (e) for dividends subject to the excess-profits tax imposed by subchapter E of chapter 2, (2) the credit provided in section 26 (h) for dividends received, and (3) in the case of a public utility, the credit provided in section 26 (h) for dividends paid on its preferred stock. For the purposes of determining the corporation surtax net income, dividends received on the preferred stock of utilities must be disregarded in computing the credit provided in section 26 (h) for dividends received. Also, for such purposes, such credit is limited to 65 percent of the corporation's dividends received.

The credit provided in section 26 (e) for income subject to the excess-profits tax imposed by subchapter E of chapter 2, rather than to the excess-profits tax on the excess of gross income over $25,000, plus 22 percent of the amount of such income over $25,000.

(3) Surtax on corporations. The tax imposed by chapter 1 is upon income. Neither income exempt by statute or fundamental law, nor expenses incurred in connection with such income, other than interest, enter into the computation of net income as defined by section 21. (See section 24 (a) (5).) In the computation of the tax various classes of income must be considered:

(a) Income (in the broad sense), meaning all wealth which flows into the taxpayer other than as a mere return of capital. It includes the forms of income described as gains and profits, including gains derived from the sale or other disposition of capital assets. Cash receipts alone do not always accurately reflect income, for the Internal Revenue Code of the United States provides for determining other factors other items, among which are inventories, accounts receivable, property, and other disposable assets. (See sections 22, 29, 24.)

(b) Gross income, meaning income in the broad sense less income which is by statutory provision or otherwise exempt from the tax imposed by chapter 1. (See section 22.)

(c) Net income, meaning gross income less statutory deductions. The statutory deductions are in general, though not exclusively, expenditures or business losses, other than capital expenditures, connected with the production of income. (See sections 23, 24.)

(d) Net income less credits. (See section 26, 24.)

The normal taxes and surtaxes imposed on individuals and on corporations are computed upon net income less certain credits. Although taxable net income as defined in statute is subject to a number of factors, among which are inventories, accounts receivable, property, and other disposable assets. In the case of a public utility, the credit provided in section 26 (h) for dividends paid on its preferred stock. For the purposes of determining the corporation surtax net income, dividends received on the preferred stock of utilities must be disregarded in computing the credit provided in section 26 (h) for dividends received. Also, for such purposes, such credit is limited to 65 percent of the corporation's dividends received.

The credit provided in section 26 (e) for income subject to the excess-profits tax imposed by subchapter E of chapter 2, rather than to the excess-profits tax on the excess of gross income over $25,000, plus 22 percent of the amount of such income over $25,000.

The computation of the surtax on corporations may be illustrated by the following example:

Example. The A Corporation, a domestic corporation which is not a public utility, has for the calendar year 1942 a net income of $59,000. The net income includes dividends received from a corporation which is not a public utility, in the amount of $9,000, and dividends received from the stock of a public utility, in the amount of $3,000. It also includes income subject to the excess stock of a corporation by subchapter E of chapter 2, in the amount of $57,000. The A Corporation's surtax for the calendar year 1942 is $6,097, computed as follows:

Net income: $59,000
Less credit for dividends received: $9,000
Gross income: $50,000
Less credit for excess-profits tax: 16 percent of $50,000
Surtax: $6,097

Tax: ($5,000 plus 22 percent of $10,000 = $4,130, the result of $5,000 plus 22 percent of $10,000). This amount paid for the property and the amount of its fair market value to the extent that such difference is in the nature of (1) compensation for services rendered or to be rendered or (2) a distribution of earnings or profits taxable as a dividend, as the case may be. In computing the gain or loss from the subsequent sale of such property, there shall be the amount paid for the property, increased by the amount of such difference included in gross income. This paragraph does not apply, however, to the issuance by a corporation to its shareholders of the right to subscribe to its stock, as to which see § 29.22 (a)–8.

The fact that a dividend is declared shortly after the sale of corporate stock and the sale price is influenced by the expectation of the payment of a dividend, does not make the dividend paid taxable to the vendor as a dividend. The amount advanced by the vendor to
shall not apply where such an agreement or understanding has been entered into prior to May 14, 1942 (the date of the approval of Treasury Decision 5151).

§ 29.22 (a)–3 Compensation paid other than in cash. If services are paid for with a note or other written instrument, 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, the amount of such compensation to be included in the gross income of the employee is the fair market value of the stock at the time of the transfer. If a person receives as compensation for services rendered a salary and in addition thereto living quarters or meals, the value to such person of the quarters and meals is included in income, subject to tax. If, however, living quarters or meals are furnished to employees for the convenience of the employer, the value thereof need not be computed and added to the salary otherwise received by the employees. The value of quarters furnished to commissioned officers, chief warrant officers, warrant officers, and enlisted personnel of the Army, Navy, Coast Guard, Coast and Geodetic Survey, and Public Health Service, or amounts received by them as commutation of quarters, are to be excluded from gross income. (See also § 29.24–3.)

§ 29.22 (a)–4 Compensation paid in notes. Notes or other evidences of indebtedness received in payment for services constitute income to the amount of their fair market value. A taxpayer receiving a note so accounted for are to be regarded as good for its face value at maturity, but not bearing interest, shall treat as income as of the time of receipt the fair discounted value of the note at such time. Thus, if it appears that such a note is of could be discounted on a 6 percent basis, the recipient shall include such note in his gross income to the amount of its face value less discount computed in the manner for such transactions. If the payments due on a note so accounted for are not made 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.

§ 29.22 (a)–5 Gross income from businesses. 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 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. But see § 29.23 (m)–1 (f).

§ 29.22 (a)–6 State contracts. The profit from a contract with a State or political subdivision thereof is to be included in gross income. If warrants are issued by a city, town, or other political subdivision of a State, and are accepted by the contractor in payment for public work done, the fair market value of such warrants should be returned as income. If for any reason the contractor upon conversion of the warrants into cash does not receive and cannot recover the full value of the warrants so returned, he may deduct from gross income for the year in which the warrants are converted into cash any less sustained, and if he realizes more than the value of the warrants so returned he should include the excess in his gross income for the year in which realized.

§ 29.22 (a)–7 Gross income of farmers. A farmer reporting on the basis of receipts and disbursements in which no inventory to determine profits is used, shall include in his gross income for the taxable year (1) the amount of cash or the value of merchandise or other property received during the taxable year from the sale of live stock and produce which were raised during the year or prior years, (2) the profits from the sale of any live stock or other items which were purchased, and (3) gross income from all other sources. The profit from the sale of live stock or other items which were purchased after February 28, 1913, is to be ascertained by deducting the cost from the sales price in the year in which the sale occurs, except that in the case of the sale of animals purchased as draft or work animals or solely for breeding or dairy purposes and not for resale, the profit shall be the amount of any excess of the sales price over the amount representing the difference between the cost and the depreciation theretore allowed (but not less than the amount allowable) in respect of such purchase as a deduction in computing net income.

In the case of a farmer reporting on the accrual basis (in which an inventory is used to determine profits), his gross profits are ascertained by adding to the inventory value of live stock and products on hand at the end of the year the amount received from the sale of live stock and products, and miscellaneous income or expenses, and subtracting from this sum the inventory value of live stock and products purchased during the year. In such cases all live stock raised or purchased for sale shall be included in the inventory at their proper valuation determined in accordance with Federal law and adopted for the purpose. Also live stock acquired, for draft, breeding, or dairy purposes and not for sale, may be included. Instead of being treated as capital assets subject to depreciation, provided such practice is followed consistently by the
taxpayer. In case of the sale of any live stock included in an inventory there may be an additional deduction in the return of income, as such deduction will be reflected in the inventory. (See § 29.22 (c)-6.)

In every case of the sale of machinery, farm equipment, or other capital assets purchased after February 28, 1913 (which are designated as farmers), the portion of the cost attributable to each class of stock or securities, but if that should be impracticable in any case, no profit on any subsequent sale of any portion of the old stock will be realized until out of the proceeds of sales shall have been recovered the total cost.

Although the issuance by a corporation to its shareholders of rights to subscribe to its stock may not under section 118(f) give rise to taxable income, gain may be derived or loss sustained by the subscription of or from the sale of such rights. In the case of stock in respect of which were acquired stock subscription rights which did not constitute income to the shareholders within the meaning of section 164 of the amendment to the Constitution, and in the case of such rights, the following rules are to be applied:

(a) If the shareholder does not exercise his rights to subscribe to the new stock, the cost or other basis, properly adjusted, of the stock in respect of which the rights are acquired shall be apportioned between the rights and the stock in proportion to the number of shares thereof at the time the rights are issued, and the basis for determining gain or loss from the sale of a right on one hand or a share of stock on the other will be the quotient of the cost or other basis, properly adjusted, assigned to the rights or the stock, divided, as the case may be, by the number of rights acquired or by the number of shares held.

Example. A taxpayer in 1939 purchased 500 shares of common stock at $125 a share, and in 1942, by reason of the ownership of such stock, acquired 600 rights entitling him to subscribe to 100 additional shares of such stock at $100 a share. Upon the issuance of the rights each of the shares of stock in respect of which the rights were acquired had a fair market value of $120, and the rights had a fair market value of $3 each. The taxpayer exercised his rights to subscribe to the additional shares and later sold one of such stock at $115.24, basis for determining gain or loss from sale of additional shares, $11,524.39 - 100 = $115.24, basis for determining gain or loss from sale of additional shares, $11,524.39 - $100 = $115.24, basis for determining gain or loss from sale of additional shares.

(b) If the stock in respect of which the rights were acquired was purchased at different times or at different prices and the identity of the lots cannot be determined, or if the stock in respect of which the rights were acquired was purchased at different times or at different prices and the stock acquired in respect of such stock cannot be identified as having been acquired in respect of any particular lot of stock, the basis for determining the gain or loss from the sale of such stock, or from the sale of other disposition of the old shares, or the stock in cases in which the rights are exercised, shall be ascertained in accordance with the principles laid down in § 29.113 (a) (12)-1.

As to deductions for losses from sales or exchanges of stocks or bonds, including losses from sales or exchanges of rights to subscribe to stock, see § 29.23 (a)-1.

§ 29.22 (a)-9 Sale of patents and copyrights. A taxpayer disposing of patents or copyrights by sale should determine the gain or loss arising therefrom by computing the difference between the selling price and the cost or other basis, with proper adjustment for depreciation, as provided in §§ 29.111-1, 29.113 (a) (14)-1, and 29.113 (b) (1)-1 to 29.113 (b) (3)-2, inclusive.
Section 29.22 (a)-10 Sale of good will. Gain or loss from a sale of good will results only when the business, or a part of it, to which the good will attaches is sold, in which case the gain or loss will be determined by comparing the sale price with the cost or other basis of the assets, including good will. (See §§ 29.111-1, 29.113 (a) (14)-1, and 29.113 (b) (13)-2, inclusive.) If specific payment was not made for good will, there can be no deductible loss with respect thereto, but gain may be realized from the sale of good will built up through expenditures which have been currently deducted. It is immaterial that good will may never have been carried on the books as an asset, but the burden of proof is on the taxpayer to establish the cost or other basis of the good will.

Section 29.22 (a)-11 Sale of real property in lots. If a tract of land is purchased with a view to dividing it into lots or parcels of ground to be sold as such, the cost or other basis shall be equitably apportioned to the several lots or parcels and not on the basis of record or of record on the books of the taxpayer, to the end that any gain derived from the sale of any such lots or parcels which constitutes taxable income may be returned and is made a matter of record on the books of the taxpayer, and not that the capital in the entire tract may be recovered before any taxable income shall be returned. The sale of each lot or parcel will be treated as a separate transaction, and gain or loss computed accordingly.

Section 29.22 (a)-12 Annuities and insurance policies. Annuities paid by religious, charitable, and educational corporations under an annuity contract are, in general, subject to tax to the same extent as annuities from other sources paid under similar contracts. (See section 29 (a) (12)-1.) An annuity charged upon devised land is taxable to the donee-annuitant to the extent it becomes payable out of the rents or other income of the land, whether or not it is a part of the income of the land. (See section 29 (b) (3) and 29.22 (b) (3)-1. As to certain cases in which an annuity charged upon devised land is taxable in full to a spouse upon divorce or legal separation, see section 22 (b) (c). In such case the devisee is not required to return as gross income the amount of rent or other income paid to the annuitant, and he is not entitled to deduct from the annuity income any sums paid to the annuitant. Amounts received as a return of premiums paid under life insurance, endowment, or annuity made a mutual form of insurance company which may be credited against the current premium, are not subject to tax.

Section 29.22 (a)-13 Cancellation of indebtedness—(a) In general. The cancellation of indebtedness, in whole or in part, may be the result of a reorganization of the debt.

If, for example, an individual performs services for a creditor, who in consideration thereof cancels the debt, income in the amount of the debt is realized by the debtor as compensation for his services. A taxpayer realizes income by the payment or purchase of his obligations at less than their face value. (See § 29.22 (a)-17.) In general, if a shareholder in a corporation which is indebted to him gratuitously forgives the debt, the transaction amounts to a contribution to the capital of the corporation to the extent of the principal of the debt.

For exclusion from gross income of income attributable to discharge of indebtedness of certain corporations, see 29.22 (b) (9)-1. A corporation from gross income attributable to discharge of indebtedness of railroad corporations in certain judicial proceedings, see 29.22 (b) (10)-1.

(b) Proceedings under Bankruptcy Act. Income is not realized by a taxpayer by virtue of the discharge, under section 14 of the Bankruptcy Act, as amended, of his indebtedness as the result of an arrangement of his creditors made by virtue of an agreement among his creditors not consummated under any provision of the Bankruptcy Act, as amended, if immediately thereafter the taxpayer's estate included the value of his assets. Furthermore, income is not realized in any case by a taxpayer in the case of a cancellation or reduction of his indebtedness under:

1. A plan of corporate reorganization confirmed under either section 77B or Chapter X of the Bankruptcy Act, as amended;

2. A composition agreement confirmed under either section 13 of the Bankruptcy Act, as amended;

3. An “arrangement” or a “real property arrangement” confirmed under Chapter XII or XIII, respectively, of the Bankruptcy Act, as amended;

4. A “wage earner’s plan” confirmed under Chapter XIII of the Bankruptcy Act, as amended.

If, however, such plan of corporate reorganization or agreement of composition is consummated under section 13 of the Bankruptcy Act, as amended, for one of its principal purposes the avoidance of income tax, the cancellation or reduction of indebtedness, under such a plan or agreement confirmed under section 13, shall be deemed to be a contribution to the capital stock of the corporation. (See §§ 29.22 (a)-13 and 29.24-2.)

Section 29.22 (a)-17 Sale and purchase of corporate stock. (a) (1) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (2) If the corporation purchases 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.

(b) (1) If, subsequent to February 28, 1913, bonds are issued by a corporation at a premium, the net amount of such premium shall be prorated or amortized over the life of the bonds. (2) If the corporation purchases any of such bonds at a price in excess of the issuing price minus any amount included in the basis of the bond by reason of premium, 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. (3) If, however, the corporation purchases any of such bonds at a price less than the issuing price minus any amount of discount already deducted (or over the face value minus any amount of discount not yet deducted) as of the purchase, such bonds is gain or income for the taxable year. (c) If bonds are issued by a corporation at a discount, the net amount of such discount to be prorated or amortized over the life of the bonds. (2) If the corporation purchases any of such bonds at a price less than the issuing price minus any amount of discount already deducted (or over the face value minus any amount of discount not yet deducted) as of the purchase, such bonds is gain or income for the taxable year. (d) (1) If bonds were issued by a corporation prior to March 1, 1913, at a premium, the net amount of such premium was deducted (or over the face value of the bonds) in which the bonds were issued and should not be prorated or amortized over the life of the bonds. (2) If the corporation purchases any of such bonds at a price less than the issuing price plus any amount of discount already deducted (or over the face value minus any amount of discount not yet deducted) as of the purchase, such bonds is gain or income for the taxable year. (3) If, however, the corporation purchases any of such bonds at a price less than 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) as of the purchase, such bonds is gain or income for the taxable year. (e) (i) For exclusion from gross income of income attributable to discharge of indebtedness of certain corporations, see § 29.22 (b) (9)–1. For exclusion from gross income of income attributable to discharge of indebtedness of railroad corporations in certain judicial proceedings, see § 29.22 (b) (10)–1.

§ 29.22 (a)–18 Sale of capital assets by corporations. If property is acquired and later sold for an amount in excess of the cost or other basis, the gain on the sale is income. If, 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 gain from such sale, computed as provided in section 113. If the purchaser takes over all the assets and assumes the liabilities, the amount so assumed is part of the selling price. § 29.22 (a)–19 Income to lessor corporation from leased property. If a corporation has leased its property in consideration that the lessee shall pay in lieu of other rental an amount equivalent to the excess of the lessor's capital stock or the interest on the lessor's outstanding indebtedness, together with taxes, insurance, or other charges, such payments shall be considered rental income. Such amount shall be returned by the lessor corporation as income, notwithstanding the fact that the dividends and interest are paid by the lessee and the shareholders and bondholders of the lessee. 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 shareholders of the lessor are rentals as to both the lessor and lessee (rentals paid in one case and rentals received in the other), to the bondholders and the shareholders such amounts are dividend payments. Any sales of property by them 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 'in partial or complete liquidation, however they may have appreciated or depreciated in value since acquisition. But see § 24 (a) and § 39.24–5. (See further § 29.52–2.)

§ 29.22 (a)–20 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 purpose. Any sales of property by them 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 'in partial or complete liquidation, however they may have appreciated or depreciated in value since acquisition. But see § 24 (a) and § 39.24–5. (See further § 29.52–2.)

[Sec. 22, Gross Income—as amended by secs. 1, 3, Public Safety Tax Act 1939; secs. 216 (a), 219 (a), Rev. Act 1938; secs. 110 (a), 112 (a), 114 (a), 115 (a), 116 (a), 117, 118 (a) (b), 119, 120 (a) (d), 125 (a) (c), 127 (d), 128 (a), 131, 132 (a), 135 (c), current Tax Payment Act 1943.]

(b) Exclusions from gross income. The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

(1) Life insurance. Amounts paid under a life insurance contract for the death of the insured, whether in a single sum or otherwise (but if such amounts are held by the insurer under an agreement to pay interest thereon, the interest payments shall be included in gross income): § 29.22 (b) (1)–1 Life insurance; amounts paid by reason of the death of the insured. The proceeds of life insurance policies, paid by reason of the death of an insured to his estate or to a beneficiary (individual, partnership, or corporation), directly or in trust, are excluded from the gross income of the beneficiary, except transfers as provided in § 29.22 (b) (2)–3 and in the case of a spouse to whom such payments are income under section 28 (k). If, however, such proceeds are held by the insurer under an agreement to pay interest thereon, the interest payments must be included in gross income. In the case of a beneficiary to whom payments are made in installments pursuant to an option exercised by such beneficiary, the amount exempted is the amount payable immediately after the death of the insured had such beneficiary not elected to exercise an option to receive the policy or any part thereof at a later date or dates. In any mode of settlement pursuant to an agreement of the insurer with a beneficiary the portion of such direct transfer of interest that is included in gross income shall be determined as follows:

(a) Proceeds held by the insurer. If the proceeds are held by the insurer under an agreement with a beneficiary to distribute either the increment to such proceeds currently, or the proceeds and increment in equal installments until
both are exhausted, there shall be included in gross income, the increment so paid to the beneficiary, or so credited to the fund in each year by the insurer.

(b) Proceeds payable in installments for a fixed number of years. If, pursuant to such an agreement, the proceeds are payable in installments for a fixed number of years, the amount that would have been payable by the insurance company immediately upon the death of the insured (if payment at a later date had not been provided for) is to be divided by the total number of installments payable over the fixed number of years for which payment is to be made, and the quotient represents the portion of each installment to be excluded from gross income. The amount of each installment in excess of such excluded portion is to be included in gross income. For example, if, at the insured's death, $1,000 would have been payable in a single installment, but 10 equal annual payments are made in lieu thereof, the portion of the installment representing the increment to be excluded from gross income is $100 ($1,000 divided by 10). Any amount received as an installment in excess of $100 is to be included in gross income.

If proceeds are payable in installments to a spouse who was divorced or legally separated from the insured under a court decree, such proceeds are to be excluded from the income of such spouse to the extent provided in the preceding paragraph only if not required to be included in her gross income under section 22 (c), relating to alimony income. Thus, if under the terms of a divorce decree, an insurance policy upon the life of the husband is to be purchased by him to provide a principal sum of $10,000 payable upon his death in 10 annual installments, with interest, to his divorced wife, the full amount of such installments received by the wife, including the interest, is to be included in her income. See further section 22 (b) (2), section 22 (k), § 22.22 (b) (2)–(4), and § 22.22 (k)–1.

(c) Proceeds payable in installments during the life of the beneficiary. If, pursuant to such an agreement, the proceeds are payable in installments during the life of the beneficiary the amount of each installment that is to be included in gross income will be determined as in paragraph (b) of this section, except that the number of years to be included in the specified computation will be determined by the life expectancy of the beneficiary, as calculated by the table of mortality used by the particular insurance company in determining the amount of the annuity; or, as provided in paragraph (c) of this section if such life expectancy exceeds the specified fixed period.

If a mode of settlement pursuant to such an agreement has been in effect prior to the first taxable year which begins after December 31, 1933 (or after December 31, 1935, in the case of a mode of settlement described in paragraph (d) of this section), the entire amount received and excluded from gross income in such prior years shall be deducted from the proceeds payable upon the death of the insured; the remainder shall be divided by the number of installments unpaid at the beginning of such taxable year (whether over the remaining portion of the fixed period or over the life expectancy as of that date, depending on the mode of settlement adopted); and that quotient shall be the exclusive portion of each installment. As such, the amount received and excluded from gross income under the methods of computation provided for in this section equals the amount of the proceeds payable upon the death of the insured, the entire amount received thereafter in each taxable year must be included in gross income.

§ 22.22 (b) (2)–1 Life insurance; endowment contracts; amounts paid other than by reason of the death of the insured. Amounts received as an annuity under a life insurance or endowment policy (other than amounts paid by reason of the death of the insured) are taxable under such amounts as paid as annuities under a life insurance or endowment contract, but if such amounts (when added to amounts received in the taxable year from such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. Amounts received as an annuity under an annuity or endowment contract shall be included in gross income; except that there shall be excluded from gross income the excess of the amount received in the taxable year over an amount equal to 3 percent of the aggregate premiums or consideration paid for such annuity (whether or not paid during such year). Any aggregate amount excluded from gross income under this chapter or prior income tax laws in respect of such annuity equals the aggregate premiums or consideration paid for such annuity. In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life income, an annuity contract, or any interest therein, only the actual value of such consideration and the amount of any annuity rights subsequently paid by the transferee shall be exempt from taxation under paragraph (i) or this paragraph. The preceding sentence shall not apply in the case of such a transfer if such contract or interest therein has a basis for determining gain or loss that has been determined in whole or in part by reference to such basis of such contract or interest therein in the hands of the transferee. This subparagraph and paragraph (i) shall not apply to the value of any interest in a life insurance, endowment, or annuity contract, or any interest therein, as, under section 22 (k), is includable in gross income; or if an annuity contract is purchased by an employer for an employee under a plan with respect to which the employer's contribution is deductible under section 22 (k) (1) (B), or if an annuity contract is purchased by an employer by an employer exempt under section 106 (i), then the entire amount received under such contract for the year received except that if the employee pays the cost of the consideration paid before the death of the annuitant, the annuity shall be included in his income as provided in subparagraph (A) of this paragraph, the consideration for such annuity being considered the amount contributed by the employee. In all other cases, if the employee's rights under the contract are not forfeitable except for failure to pay future premiums, the amount contributed by the employer for such annuity contract on or after such rights become nonforfeitable shall be included in the income of the employee in the year in which the amounts is contributed, which amount together with any amounts contributed after such time shall constitute the consideration paid for the annuity contract in determining the amount of the annuity includable in the income of the employee under subparagraph (A) of this paragraph.

22.22 (b) (2)–2 Annuities. Amounts received as an annuity under an annuity or endowment contract include amounts received in pecuniary installments, whether annually, semiannually, quarterly, monthly, or otherwise, and whether for a fixed period, such as a term of years, or for an indefinite period, such as for life, or for life and a guaranteed fixed period, and which installments are payable or may be payable for a period longer than one year. Such consideration of each installment (except to the extent of the amount paid for which the consideration is paid) shall be included in gross income as is not in excess of 3 percent of the aggregate premiums or consideration paid for such annuity, whether or not paid during the taxable year, divided by 12 and multiplied by the number of months in respect of which the installment is paid. As soon as the aggregate of the amounts received and excluded from gross income equals the aggregate premiums or consideration paid for such annuity, whether or not paid during the taxable year, divided by 12 and multiplied by the number of months in respect of which the installment is paid.
employees pursuant to the Civil Service Retirement Act of May 29, 1930, 46 Stat. 486, 475, as amended (5 U. S. C., 1949 ed., ch. 14), are subject to section 22 (b) (2), the aggregate premiums or consideration paid for such annuities being the total of the receipt of such annuities held from the compensation of the employee.

The provisions of this section may be illustrated by the following examples:

Example (1). A bought in 1939, for $50,000 in annual installments of $5,000. For the calendar year 1943 he would be required to include in gross income $5,000 received during that year (3 percent of $50,000), $3,600 being exempt. If A should live long enough to receive as exempt $50,000, then all amounts he receives thereafter under the annuity contract would be included in gross income.

Example (2). A bought an annuity on October 1, 1943, paying $10,000 as consideration therefor. The annuity amounts to $7,894 a year, payable in semiannual installments of $3,947, and on December 1, 1943, A received $1,501, the first payment under the contract being for a 2-month period. A would include in his gross income for the calendar year 1943 the sum of $800, being 3 percent of $10,000 (the consideration paid) divided by 12 and multiplied by 3 (the number of months in respect of which the installment was paid).

Example (3). A bought an increasing annuity on August 1, 1942, paying $40,000 as consideration therefor. The annuity amounts to $6,000 a year for the first year, $6,000 a year for the second year, and $8,000 a year thereafter, payable in quarterly installments. A received the first quarterly installment on November 1, 1942, paying $1,500, to which the contract paid $600. Similarly, $400 was included in his gross income. The total amount of such annuity shall be included in the income of the employee in the taxable year in which such annuity is made.

Example (4). In 1942, the M Corporation procured, for a premium of $8,000, an insurance policy in the face amount of $1,000 upon the life of X, one of its employees, naming the N Corporation as beneficiary. If X dies during the time the policy is held by the corporation, the proceeds paid by reason of the death of X would be taxable to the extent of $600 ($1,000 minus $400). Similarly, if, before the death of X, the M Corporation transferred the policy to the C Corporation in a tax-free reorganization, the proceeds in the hands of the transferee, because the basis is determined with reference to the basis in the hands of the transferee.

The following examples illustrate the application of the provisions of this section:

Example (1). The A Corporation procures, for a premium of $8,000, an insurance policy in the face amount of $1,000 upon the life of X, one of its employees, naming the A Corporation as beneficiary. If X dies during the time the policy is held by the corporation, the proceeds paid by reason of the death of X would be taxable to the extent of $600 ($1,000 minus $400). Similarly, if, before the death of X, the M Corporation transferred the policy to the C Corporation in a tax-free reorganization, the proceeds in the hands of the transferee, because the basis is determined with reference to the basis in the hands of the transferee.

Example (2). A, in 1940, transferred his policy to the B Corporation for a consideration of $20,000. After payment of premiums totaling $5,000, the $20,000 received upon maturity of the policy (while A is still alive) would be includable in the income of the A Corporation in the taxable year in which such annuity is made.

Example (3). A corporation transferred its assets, including the policy, to the B Corporation in a tax-free exchange for the stock of the B Corporation. The proceeds of the policy paid to the corporation in the face amount of $1,000 upon the life of X, one of its officers, naming the B Corporation as beneficiary. If X dies during the time the policy is held by the corporation, the proceeds paid by reason of the death of X would be taxable to the extent of $600 ($1,000 minus $400). Similarly, if, before the death of X, the M Corporation transferred the policy to the C Corporation in a tax-free reorganization, the proceeds in the hands of the transferee, because the basis is determined with reference to the basis in the hands of the transferee.

Example (4). A, in 1940, transferred his policy to the B Corporation for a consideration of $20,000. After payment of premiums totaling $5,000, the $20,000 received upon maturity of the policy (while A is still alive) would be includable in the income of the A Corporation in the taxable year in which such annuity is made.
except that if the employee contributed any of the consideration for the annuity, the annuity shall be included in his income. The annuity shall be included in his income to the extent provided in \$29.22 (b) (3). If such annuity is paid, credited, or to be distributed at intervals, to the extent the amounts in either case are paid, credited, or to be distributed at intervals out of income they are not to be excluded under paragraph (b) (3). If the annuity is paid, credited, or to be distributed out of income from property, it shall be considered a gift, bequest, devise, or inheritance of income from property. Section 22 (b) (3) is designed to provide for other amounts of income from property, which income is paid, credited, or to be distributed under a gift or bequest, whether the gift or bequest is in terms of a right to payment of income or of income (other than income) or in terms of a right to income. To the extent the amounts in either case are paid, credited, or to be distributed at intervals out of income they are not to be excluded under paragraph (b) (3). If the annuity is paid, credited, or to be distributed out of income from property, it shall be considered a gift, bequest, devise, or inheritance of income from property.

Section 22 (b) (3) is designed to provide for other amounts of income from property, which income is paid, credited, or to be distributed under a gift or bequest, whether the gift or bequest is in terms of a right to payment of income or of income (other than income) or in terms of a right to income. To the extent the amounts in either case are paid, credited, or to be distributed at intervals out of income they are not to be excluded under paragraph (b) (3). If the annuity is paid, credited, or to be distributed out of income from property, it shall be considered a gift, bequest, devise, or inheritance of income from property.

Section 22 (b) (3) is designed to provide for other amounts of income from property, which income is paid, credited, or to be distributed under a gift or bequest, whether the gift or bequest is in terms of a right to payment of income or of income (other than income) or in terms of a right to income. To the extent the amounts in either case are paid, credited, or to be distributed at intervals out of income they are not to be excluded under paragraph (b) (3). If the annuity is paid, credited, or to be distributed out of income from property, it shall be considered a gift, bequest, devise, or inheritance of income from property.

The annuity shall be included in his income to the extent provided in \$29.22 (b) (3). If such annuity is paid, credited, or to be distributed at intervals, to the extent the amounts in either case are paid, credited, or to be distributed at intervals out of income they are not to be excluded under paragraph (b) (3). If the annuity is paid, credited, or to be distributed out of income from property, it shall be considered a gift, bequest, devise, or inheritance of income from property.

Section 22 (b) (3) is designed to provide for other amounts of income from property, which income is paid, credited, or to be distributed under a gift or bequest, whether the gift or bequest is in terms of a right to payment of income or of income (other than income) or in terms of a right to income. To the extent the amounts in either case are paid, credited, or to be distributed at intervals out of income they are not to be excluded under paragraph (b) (3). If the annuity is paid, credited, or to be distributed out of income from property, it shall be considered a gift, bequest, devise, or inheritance of income from property.

Section 22 (b) (3) is designed to provide for other amounts of income from property, which income is paid, credited, or to be distributed under a gift or bequest, whether the gift or bequest is in terms of a right to payment of income or of income (other than income) or in terms of a right to income. To the extent the amounts in either case are paid, credited, or to be distributed at intervals out of income they are not to be excluded under paragraph (b) (3). If the annuity is paid, credited, or to be distributed out of income from property, it shall be considered a gift, bequest, devise, or inheritance of income from property.
and the District of Columbia, and any political subdivision thereof, and any agency or instrumentalitv of the United States acting thereunder, shall be considered as an agency or instrumentalitv of the United States.

(b) The provisions of this section shall, with respect to such obligations, be considered as amendatory of and supplementary to the respective Acts or parts of Acts authorizing the issuance of such obligations, as amended and supplemented.

Sec. 5. Title Act, except sections 2 (b) and (c), shall become effective on the first day of the month following the date of its enactment.

PUBLIC DEBT ACT OF 1942 (APPROVED MARCH 28, 1942)

Sec. 6. Section 4 of the Public Debt Act of 1941 (Public Numbered 7, Seventy-seventh Congress, first session), is hereby amended to read as follows:

(a) (1) Interest upon obligations, and dividends, earnings, or other income from shares, certificates, stock, or other evidences of ownership, as amended and supplemented.

(b) (4)–2 Dividends from shares and stock of Federal agencies or instrumentalities—(a) Issued prior to March 28, 1942. Section 26 of the Federal Farm Loan Act of July 17, 1916 (38 Stat. 289, 12 U.S.C., 931), provides that Federal land banks and national farm-loan associations, including the capital and reserve or surplus therein and the income derived therefrom, shall, when issued, be exempt from taxes upon real estate. Section 7 of the Federal Reserve Act of December 23, 1913 (38 Stat. 551, 12 U.S.C., 551), provides that Federal reserve banks, including the capital stock of the Federal Reserve Bank of New York, issued after March 28, 1914, shall be exempt from taxation, except taxes upon real estate. Section 5 (b) of the Home Owners' Loan Act of 1933 (48 Stat. 318, 12 U.S.C., 1437), provides that shares of Federal savings and loan associations shall, both as to their value and the income therefrom, be exempt from all taxation (except surtax and estate and inheritance taxes) imposed by the United States. Under the above-mentioned provisions, income consisting of dividends on stock of Federal land banks, national farm-loan associations, and Federal reserve banks is not, in the case of stock issued prior to March 28, 1942, subject to the income tax; and income consisting of dividends on shares issued after March 28, 1942, is not, in the case of shares issued prior to March 28, 1942, subject to the normal tax on income. For taxability of such income in the case of stock issued after March 28, 1942, or of shares issued after March 28, 1942, see section 6 of the Public Debt Act of 1942 and paragraph (b) of this section. For the time at which a stock or share is issued within the meaning of this section, see paragraph (b) of this section.

(c) The provisions of this section shall, with respect to such obligations and evidences of ownership, be considered as amendatory of and supplementary to the respective Acts or parts of Acts authorizing the issuance of such obligations, as amended and supplemented.

(d) Nothing herein shall be construed to amend or repeal sections 114 and 115 of the Revenue Act of 1941.

§ 29.22 (b) (4)–2 Interest upon State obligations. Interest upon the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia, is exempt from the income tax. Obligations issued by or on behalf of the State or Territory or a duly organized political subdivision acting by constituted authorities empowered to issue such obligations are the obligations of a State or Territory or a political subdivision thereof. Special tax bills issued for special benefits to property, if such tax bills are legally collectible only from owners of the property benefited, are not the obligations of a State, Territory, or political subdivision. The term "political subdivision," within the meaning of the exception, denotes any division of the State or Territory which is a municipal corporation, or to which has been delegated the right to exercise part of the sovereign power of the State or Territory. As thus defined, a political subdivision of a State or Territory may or may not, for the purpose of exemption, include any one or more counties or other districts or parts of counties, and the districts or parts of counties so included shall, when issued, be exempt from taxes upon real estate.

EXAMPLE (1): A, the owner of an investment share account, consisting of 10 shares, of the Federal National Bank, and Loan Association, has a single certificate issued prior to March 28, 1942, evidencing such ownership. In the case of such ownership, the shares, the association at his request issues, after March 27, 1942, two 5-share certificates in substitution for the 10-share certificate. The certificate evidencing the 10 shares is retired in exchange for new stock of a different character or preference, the new stock being deemed to have been issued at the time of the exchange rather than when the old stock was paid for. This paragraph may be illustrated by the following examples:

Example (2): A, the owner of a savings share account, in the amount of $500, in a Federal savings and loan association, has a passbook containing a certificate issued prior to March 28, 1942, evidencing such ownership. Subsequent to March 27, 1942, A deposits $10,000 in the account. With respect to the $10,000 deposit, the share is deemed to have been issued after March 27, 1942.

Example (3): A, the owner of a savings share account, in the amount of $500, in a Federal savings and loan association, has a passbook containing a certificate issued prior to March 28, 1942, evidencing such ownership. Subsequent to March 27, 1942, A deposits $10,000 in the account. With respect to the $10,000 deposit, the share is deemed to have been issued after March 27, 1942.
mortgages is not subject to the income tax.

§ 29.22 (b) (4)–4 Interest upon United States obligations.—(a) Issued prior to March 1, 1941. Although interest upon the obligations of the United States and its possessions and upon obligations of a corporation organized under Act of Congress, if such corporation is an instrumentality of the United States, is generally exempt from tax, in the case of obligations issued by the United States after September 1, 1917, which include Treasury certificates of indebtedness, Treasury bonds, and Treasury notes, and in the case of obligations of a corporation organized under Act of Congress, the interest is exempt from tax only if and to the extent provided in the Acts authorizing the issue thereof, as amended and supplemented.

Every person owning any of the obligations enumerated in clause (A), (B), or (C) of section 23 (b) (4) shall submit in his income tax return a statement showing his interest in and to amount of such obligations owned and the income received therefrom. For the purpose of such statement, in the case of Treasury bills issued after June 17, 1918, the “amount of the obligations” is the maturity value and the “income received therefrom” is the net excess of the amount realized during the taxable year from the sale or other disposition of the bonds or other basis thereof, a separate computation of discount being unnecessary.

The interest on Treasury certificates of indebtedness is entirely exempt from Federal income taxes. Interest upon United States obligations is not subject to the income tax.

Interest credited to postal savings accounts on moneys deposited prior to March 1, 1941, in postal savings banks is wholly exempt from income tax.

(b) Issued on or after March 1, 1941. By virtue of sections 4 and 5 of the Public Debt Act of 1941 (55 Stat. 9), the exemption prescribed in paragraph (a) of this section is limited to such bonds, debentures, notes, or certificates as have been issued prior to March 1, 1941.

Under such provisions of the Public Debt Act of 1941, interest upon obligations issued on or after March 1, 1941, by the United States, or the agency or instrumentality thereof, shall not have any exemption, as such, from Federal tax now or hereafter imposed except in respect of any such obligations which the United States makes to the Federal Housing Administration or the Federal Housing Commissioner or the Federal Home Loan Board or the Federal Home Loan Bank System or any agency or instrumentality of the United States, and of the District of Columbia and any political subdivisions thereof, and agency or instrumentality of any one or more of the foregoing, shall not be considered as an agency or instrumentality of the United States.

The following items shall not be included in gross income and shall be exempt from taxation under this subchapter:

(i) Compensation for injuries or sickness, except in the case of amounts attributable to personal services of a physician in connection with personal services of a physician, under section 23 (a) in any prior taxable year, 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 otherwise on account of personal injuries or sickness, and amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country.

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

(iii) Income exempt from tax, of any individual, to the extent required by any treaty obligeation of the United States;

(iv) Miscellaneous items. The following items for the extent provided under section 116:

(a) Earned income from sources without the United States;

(b) Income of certain Territorial employees;

(c) Income of foreign governments;

(d) Income of States, municipalities, and other political subdivisions;

(e) Receipts of shippers’ mutual protection and indemnity associations;

(f) Dividends from China Trade Act corporations;

(g) Compensation of employees of foreign governments;

(h) Income from discharge of indebtedness. In the case of a discharge of indebtedness, the amount of any income of the taxpayer attributable to such discharge, with respect to any indebtedness of the taxpayer for which the taxpayer is liable, evidence by a security (as hereinafter in this paragraph defined) if the taxpayer makes and files the return, in such manner as the Commissioner, with the approval of the Secretary, by regulation prescribed under section 113 (b) (3) in effect. In such case the amount of any income of the taxpayer attributable to any unamortized premium (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall be included in gross income and the amount of

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the deduction attributable to any unamortized discount (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall not be allowed as a deduction. As used in this paragraph the term "any bond, debenture, note, or certificate, or other evidence of indebtedness, issued by any corporation."

This paragraph shall not apply to any discharge before the date of enactment of the Revenue Act of 1939, or in a taxable year beginning after December 31, 1945.

§ 29.22 (b) (9)-1 Income from discharge of indebtedness. Section 22 (b) (9) provides, with respect to taxable years beginning after December 31, 1941, and before January 1, 1946, a method whereby a corporation may elect to have excluded from gross income and the amount of the deduction attributable to such discharge, within the taxable year, of its indebtedness or of indebtedness for which it is liable as, for example, in the case of a lessor of real property or any other corporation. As used in this section "indebtedness" means indebtedness evidenced by a security, that is, a bond, debenture, note, or certificate, or other evidence of indebtedness issued by either the taxpayer corporation or any other corporation regardless of when issued.

Discharges of indebtedness including discharges occurring in a proceeding under Chapter XV of the Bankruptcy Act of 1898, as amended, if such proceeding was initiated by petition filed on or after October 16, 1942, and on or before November 1, 1945, occurring in a taxable year beginning after December 31, 1941, and prior to January 1, 1946, are governed by the provisions of section 22 (b) (9).

If as a result of the discharge of indebtedness there remains unamortized premium or unamortized discount, the amount of the income attributable to such premium is to be excluded from gross income and the amount of the deduction attributable to such discharge shall be disallowed as a deduction. The unamortized premium and unamortized discount, as the case may be, evidence of indebtedness issued by either the taxpayer corporation or any other corporation, regardless of when issued.

Discharges of indebtedness including discharges occurring in a proceeding under Chapter XV of the Bankruptcy Act of 1898, as amended, if such proceeding was initiated by petition filed on or after October 16, 1942, and on or before November 1, 1945, occurring in a taxable year beginning after December 31, 1941, and prior to January 1, 1946, are governed by the provisions of section 22 (b) (9).

§ 29.22 (b) (9)-2 Making and filing of consent. A consent to have the basis of its property adjusted in accordance with the provisions of the regulations, in effect at the time of the filing of the return, prescribed under section 113 (b) (3) (see §§ 29.113 (b) (3) and 29.113 (b) (3) 1) shall be made in or before March of the year in which the discharge of indebtedness occurred. In accordance with these regulations and the instructions on the form or issued therewith. The original and duplicate shall be filed with the return.

As used in this section "discharge of indebtedness" means indebtedness evidenced by a security, that is, a bond, debenture, note, or certificate, or other evidence of indebtedness issued by either the payer corporation or any other corporation. This paragraph shall not apply to any discharge before the date of enactment of the Revenue Act of 1939, or in a taxable year beginning after December 31, 1945.

§ 29.22 (b) (10)-1 Income from discharge of indebtedness of a railroad corporation. The amount of any income attributable to the discharge of indebtedness of a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended, if such proceed- ing is deemed to have been realized by reason of a modification or in cancellation in whole or in part of such indebtedness pursuant to an agreement in principle proceeding or in a proceeding under section 77 of the National Bankruptcy Act, as amended. In the case of the discharge of indebtedness of the tax- payer attributable to any unamortized premium (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall not be included in gross income and the amount of the deduction attributable to such discharge (computed as of the first day of the taxable year in which such discharge occurred) shall be disallowed as a deduction. Paragraph (9) shall not apply with respect to any discharge of indebtedness to which this paragraph applies. Paragraph (9) shall not apply to a discharge occurring in a taxable year beginning after December 31, 1945.

§ 29.22 (b) (10)-2 Income from discharge of indebtedness of a railroad corporation. Under section 77B of a railroad corporation as a result of an order in a reorganization proceeding, or in a railroad reorganization proceeding under section 77 of the Bankruptcy Act of 1898, as amended, if, for taxable years beginning before January 1, 1946, excluding from the gross income of the railroad corporation. The section is applicable only in a case where income accrues to a taxpayer from the modification or cancellation of the corporate indebtedness (whether by carrying on or in part) pursuant to a court order.

The railroad corporations to which this section and section 22 (b) (10) apply are those defined in section 77m of the Bankruptcy Act of 1898, as amended, namely, any common carrier, defined as a railroad engaged in the transportation of persons or property in interstate commerce, except a street, a suburban, or inter-

urban electric railway which is not operated as a part of a general railroad system of transportation or which does not derive more than 50 percent of its operating revenues from the transportation of freight in standard railroad freight equipment.

As used in section 22 (b) (10) and this section to terminate indebtedness, an obligation, absolute and not contingent, to pay on demand or within a given time, in cash or other medium, a fixed amount.

For the purpose of this paragraph, the amount of the indebtedness, there remains unamortized premium or unamortized discount, the amount of the income attributable to this premium is to be excluded from gross income and the amount of the deduction attributable to such discount shall be disallowed as a deduction. The unamortized premium and unamortized discount, as the case may be, in each instance to be computed as of the first day of the taxable year in which the discharge of indebtedness occurred.

The provisions of section 22 (b) (10) and this section are applicable to taxable years beginning after January 1, 1946.

(11) Improvements by lessee on lessor's property. Income, other than rent, derived by a lessee of real property upon the termination of the lease, representing the value of such property attributable to buildings erected or other improvements made by the lessee.

§ 29.22 (b) (11)-1 Exclusion from gross income of lessor of real property of value of improvements erected by lessee. Income derived by a lessor of real property upon the termination, through foreclosure or other disposition of such property and attributable to buildings erected or other improvements made by the lessee upon the leased property is excluded from gross income. However, where the facts disclose that such buildings or improvements represent in whole or in part a liquidation in kind of lease rentals, the exclusion from gross income shall not apply to the extent that such buildings or improvements represent such liquidation. The exclusion applies only with respect to the income realized by the lessor upon the termination of the lease and not attributable to buildings erected or other improvements made by the lessee subsequent to the termination of the lease incident to the
ownership of such buildings or improvements.

The provisions of this section may be illustrated by the following example:

Example: A building was leased in 1935 for a period of 50 years unimproved real property to the B Corporation under a lease providing that the B Corporation erect on the site of the building a building of $500,000. In addition to paying the A Corporation a lease rental of $10,000 per annum in the first 25 years, the lessees paid $10,000 in escrow for the payment of the rental. The building was completed on January 1, 1937, and in accordance with an option granted in the lease, the ownership of such buildings or improvements made by the lessees on the leased property would become the absolute property of the B Corporation providing that the B Corporation erect a building rental of $10,000. The building was completed on January 1, 1937, and in accordance with an option granted in the lease, the ownership of such buildings or improvements made by the lessees on the leased property would become the absolute property of the B Corporation. The building was completed on January 1, 1937, and in accordance with an option granted in the lease, the ownership of such buildings or improvements made by the lessees on the leased property would become the absolute property of the B Corporation.

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year of any recovery, the section 22 (b) (12) items which were deducted or credited for one prior year are considered as a group and the recovery thereon is considered separately from recoveries of any items which were deducted or credited for other years. The recovery item excluded from gross income to the extent of the recovery exclusion with respect to this group of items as (1) determined for the original year for which such items were deducted or credited (see (2), below, of this paragraph) and (ii) reduced by the recoveries in intervening years on account of all section 22 (b) (12) items for such original year. A taxpayer claiming a recovery item income exclusion under this paragraph at the time the exclusion is claimed, the computation of the recovery exclusion claimed for the original year for which the items were deducted or credited, and computations of the recovery item exclusion for the recovery item income in recovering items which were deducted or credited reduced or credited (see (2), below, of this paragraph) and (ii) reduced by the recoveries in intervening years on account of all section 22 (b) (12) items deducted or credited for the original year.

(2) Determination of recovery exclusion for recoverable items which were deducted or credited. The recovery exclusion for the taxable year for which section (b) (12) items were deducted or credited or section 22 (b) (12) items were deducted or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited reduced or credited 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for military and naval personnel. So much of the amount received before the termination of the present war as proclaimed by the President, by personnel below the grade of commissioned officer in the military or naval forces of the United States as salary or compensation in any form from the United States for active service during the present war, as does not exceed $250 in the case of a single person and $300 in the case of a married person or the head of a family, shall not be made as compensation for services rendered while in active service.

(b) Taxable years beginning after December 31, 1942. For any taxable year beginning after December 31, 1942, in addition to other exemptions and credits otherwise applicable, there may be excluded from gross income in the case of:

(1) A member of the military or naval forces of the United States or a citizen or resident of the United States who is a member of the military or naval forces of any of the other Nations so much of the compensation for active service in such forces during the present war as does not exceed the sum of $1,500. Such exclusion is applicable without distinction as to age or to the marital status of the recipient of such compensation but is applicable only to such compensation received prior to the termination of the present war to be fixed by proclamation of the President. If the husband and wife both meet such requirements, then each is entitled to exclude such amount from gross income.

For the purposes of this subsection the military and naval forces of the United States include (but are not necessarily limited to) the Army, the Navy, the Marine Corps, the Coast Guard, the Army Nurse Corps, Female, the Navy Nurse Corps, Female, the Women's Army Auxiliary Corps or the Women's Army Corps, the Women's Reserve branch of the Naval Reserve, the Marine Corps Women's Reserve branch of the Coast Guard Reserve, including the Coast Guard Women's Reserve. For the purposes of this subsection the term "member of the military or naval forces of any of the United Nations" shall mean any individual whose duties in the service of any of the United Nations other than the United States correspond to those of any member of the military or naval forces of the United States as defined in this section.

A person is in active service if he is actually serving in such forces, not necessarily in the field or in the theater of war. Personnel in the inactive reserve or on retirement are not in active service. Periods during which a person is absent from duty on account of sickness, wounds, leave, interment by the enemy, or other lawful cause are periods of active service.

This exemption does not apply to salary or compensation received by such person subsequent to discharge or release from active service even though payment may have been made as compensation for services rendered while in active service.

§ 29.22 (b) (3) Compensation of military and naval forces—(a) Taxable years beginning after December 31, 1942. For any taxable year beginning after December 31, 1942, in addition to other exemptions and credits otherwise applicable, there may be excluded from gross income in the case of:

(1) A member of the military or naval forces of the United States as salary or compensation in any form from the United States for active service during the present war, as does not exceed $250 in the case of a single person and $300 in the case of a married person or the head of a family, shall not be made as compensation for services rendered while in active service.

(b) Taxable years beginning after December 31, 1942. For any taxable year beginning after December 31, 1942, and prior to January 1, 1943, a person below the grade of commissioned officer in the military or naval forces of the United States during the present war may exclude from gross income salary or compensation received prior to the termination of the present war for such service, in an amount not in excess of $250 if single or $300 if married or the head of a family, if the husband and wife both meet such requirements, but the exclusion is not limited to the $300 exclusion. The exemption under this paragraph does not apply to compensation received before January 1, 1942, or after the close of the taxable year of the taxpayer beginning before January 1, 1943.

As to what constitutes the military and naval forces of the United States for the purposes of this paragraph, see paragraph (a) of this paragraph. The purposes of this paragraph serve with the Army Specialist Corps are not within the scope of the exemption. As to what constitutes active service for the purposes of this paragraph, see paragraph (a) of this section.

This exemption does not apply to salary or compensation received by such person subsequent to discharge or release from active service even though payment may have been made as compensation for services rendered while in active service.

For the purposes of this paragraph, whether a person is in active service in the military or naval forces of the United States and whether such person is single, married, or the head of a family is determined by such person's status on the last day of the taxable year.

§ 29.22 (c) Valuation of inventories. Section 22 (c) provides two tests to which each inventory must conform:

(a) It must conform as nearly as may be to the best accounting practice in the trade or business, and

(b) It must clearly reflect the income.

It follows, therefore, that inventory rules cannot be uniform. What is necessary is to have an effect to trade customs which come within the scope of the best accounting practice in the particular trade or business. In order clearly to reflect income, the inventory practice of a taxpayer should be consistent from year to year, and greater weight is to be given to consistency than to any particular method of inventorying or basis of valuation. As long as the method or basis used is substantially in accord with these regulations, an inventory that can be used under the best accounting practice in a balance sheet showing the financial position of the taxpayer can, as a general rule, be regarded as clearly reflecting his income.

The bases of valuation most commonly used by business concerns and which must be regulated by the regulations under section 22 (c) are (a) cost and (b) carryover cost, whichever is lower. (For inventories by dealers in securities, see § 29.22 (c) 5.) Any goods in an inventory which are unsalable at normal prices or which are substantially damaged, in the normal way because of damage, imperfections, shop wear, changes of style, odd or broken lots, or other similar causes, including second-hand goods taken in exchange, should be valued at bona fide selling prices less direct cost of disposition, whether basis (a) or (b) is used, or if such goods consist of raw materials or partly finished goods held for resale, at the cost or consignor price, if such selling basis come within the classification indicated above, and he shall maintain such records of the disposition of the goods as will enable a verification of the inventory to be made.
In respect of normal goods, whichever basis is adopted must be applied with reasonable consistency to the entire inventory except as to those goods inventoried under the elective method authorized by section 22 (d). Taxpayers were given an option to adopt the basis of either (a) cost or (b) market, whichever is lower, for their 1920 inventories. The basis properly adopted for that year must be consistently retained, and a change can now be made only after permission is secured from the Commissioner. Application for permission to change the basis of valuing inventories must be made in writing and filed with the Commissioner as provided in § 29.41–2. Goods taken in the inventory which have been so intermingled that they cannot be identified with specific invoices will be deemed to be the goods most recently purchased or produced, and the cost thereof will be the actual cost of the goods purchased or produced during the period in which the quantity of the inventory involved has been acquired. But see section 22 (d) as to inventories under elective method. Where the taxpayer maintains book inventories under the cost method of accounting, such inventories must be maintained in accordance with a sound accounting system in which the respective inventory accounts are charged with the actual cost of the goods purchased or produced and credited with the value of goods sold, transferred, or, where sold, calculated upon the basis of the actual cost of the goods acquired during the taxable year (including the inventory at the beginning of the year), the net value of which have been transferred or sold. Inventories taken at a time other than the end of the taxable year (including the inventory at the beginning of the year), the net value of which have been transferred or sold. Inventories should be recorded in a legible manner, properly computed and summarized, and should be preserved in such books or records as the Commissioner may require. The inventories of taxpayers on whatever basis taken will be subject to investigation by the Commissioner, and the taxpayer must satisfy the Commissioner of the correctness of the prices adopted.

The following methods, among others, are sometimes used in taking or valuing inventories, but are not accorded the same degree of recognition:

(a) Cost

The cost method involves the determination of the cost of goods sold. This is generally accomplished by taking inventory at the beginning of the taxable year and then subtracting the ending inventory from the beginning inventory. The difference represents the cost of goods sold. The cost of goods sold is then deducted from the sales revenue to determine the gross profit. The cost method is based on the principle of consistency and is considered the most straightforward method of valuing inventories. It is particularly useful for businesses that prefer to maintain a record of the actual cost of goods sold. However, it can be time-consuming and labor-intensive, especially for businesses with a large volume of transactions.

(b) Market

The market method involves valuing inventories at the current market price. This method requires regular monitoring of market conditions and updates the inventory values to reflect the current market price. The market method is considered the most accurate method of valuing inventories as it reflects the true value of the goods. However, it can be difficult to determine the market price, especially for unique or perishable goods. Furthermore, it requires the constant updating of the inventory values, which can be a time-consuming and costly process.

(c) Cost or Market

The cost or market method involves valuing inventories at either cost or market, whichever is lower. This method combines the benefits of both the cost and market methods, providing a more flexible approach to inventory valuation. It is particularly useful for businesses that prefer to maintain a record of the actual cost of goods sold, but also want to reflect the current market price. However, it can be difficult to determine whether to use cost or market, especially for businesses with a large volume of transactions.

(d) Elective Method

The elective method allows businesses to choose the most appropriate method of valuing inventories. This method provides a degree of flexibility, allowing businesses to select the method that best suits their specific needs. However, it can be difficult to determine which method to use, especially for businesses with a large volume of transactions.
ercised will be binding upon the taxpayer for the year for which the option is exercised and for subsequent years unless another method is authorized by the Commissioner.

(a) Opening and closing inventories shall be made at the beginning and the close of each taxable year in which a change is made. There should be included in the opening inventory all farm products (including livestock) purchased or raised which were on hand at the date of the inventory, and there must be submitted with the return, for the current taxable year an adjustment sheet for the preceding taxable year based on the inventory method, upon the amount of which adjustment the tax shall be assessed and paid (if any be due) at the rate of tax in effect for that year. Ordinarily an adjustment sheet for the preceding year will be sufficient, but if, in the opinion of the Commissioner, use such allocated cost as a basis for pricing inventories, provided such allocation bears a reasonable relation to the respective market values of the different kinds, sizes, or grades, the unit cost of which is substantially alike, and who in conformity to a recognized trade practice allocates an amount of cost to each kind, size, or grade of product, in which the aggregate will absorb the total cost of production, may, with the consent of the Commissioner, use such allocated cost as a basis for pricing inventories, provided such allocation bears a reasonable relation to the respective market values of the different kinds, sizes, or grades of product. See section 22(d) as to inventories under elective method.

(b) The total of the taxable income for the year for which the option is exercised will be binding upon the taxpayer. The amount should represent as accurately as may be the amounts added to the cost price of the goods to cover selling and other expenses of doing business and for the margin of profit.

A taxpayer maintaining more than one department in his store or dealing in classes of goods carrying different percentages of gross profit should not use a percentage of profit based upon an average of his entire business, but should compute and use in valuing his inventory the respective percentages for the respective departments or classes of goods.

A taxpayer who previously has determined inventories in accordance with the foregoing, except that, to obtain a basis of approximate cost or market, whichever is lower, the practice has been followed, consistently and uniformly, of valuing goods included in the opening inventory at the cost of such goods included; and the mark-downs included must be reduced by the mark-downs made to cancel or correct such mark-ups.

In no event shall mark-downs not based on actual reduction of retail sales prices, such as mark-downs based on depreciation and obsolescence, be recognized in determining the retail selling prices of the goods on hand at the end of the year.

A taxpayer who previously has determined inventories without following the practice of eliminating mark-downs in making adjustments to retail selling prices, may adopt such practice, provided the Commissioner shall not be required to make special examinations for that purpose. The Commissioner may by a written order, upon filing of a request, require the Commissioner upon examination of the return.

**FEDERAL REGISTER, Wednesday, November 3, 1943**
(O) Treat those included in the opening inventory of the taxable year in which such method is first used as having been acquired at the same time and determine their cost by the average cost method.

(2) The method described in paragraph (1) may be used—

(A) only in inventoring goods (required under subsection (d) or (e) to be inventoried) at such time and in such manner as the Commissioner may prescribe; and

(B) only if the taxpayer establishes to the satisfaction of the Commissioner that the taxpayer has used no other procedure other than that specified in subparagraph (B) of paragraph (1) in inventoring such goods to ascertain the income, profit, or loss of the taxpayer for the year of involuntary liquidation over the aggregate cost basis of such goods or over the aggregate cost thereof as reduced pursuant to the provisions of paragraph (1) of this section.

§ 29.22 (d)–1 Inventories under elective method.

Any taxpayer permitted or required to take inventories pursuant to the provisions of section 22 (d) and (e), and pursuant to the provisions of §§ § 29.22 (d)–1 through 29.22 (d)–6, inclusive, may elect, after the filing of a claim for refund, for erroneous refund based upon any item, inclusion, deduction, credit, or other determination resulting from the effect of subparagraph (A) of § 29.22 (d)–1, a change to a different method of inventoring such goods specified in his application and properly subject to inventory to compute his opening and closing inventories in accordance with the method provided by section 22 (d).

Under this elective inventory method, the taxpayer is permitted to treat those goods remaining on hand at the close of the taxable year as being—

First, included in the opening inventory of the taxable year, in the order of acquisition and to the extent thereof, and

Second, those acquired during the taxable year.

This elective inventory method is not dependent upon the character of the business in which the taxpayer is engaged, or upon the identity or want of identity through casuistry of any of the goods on hand, and may be adopted by the taxpayer as of the close of any taxable year.

If the elective inventory method is used by a taxpayer who regularly and consistently uses a method of inventoring on a futures market, matches purchases with sales, then firm purchases and sales contracts (i. e., those not legally subject to cancellation by either party) entered into at a fixed price, then the value of such goods on the date of the filing of such claim for refund, the adjustment is so prevented, the amount of the adjustment authorized by this paragraph shall be limited to the excess of the aggregate cost of such goods over the aggregate cost thereof as reduced solely from the effect of subparagraph (A) of § 29.22 (d)–1, and such amount shall be assessed and collected, or credited or refunded, in the same manner as if it were a deficiency or an overpayment, as the case may be, for such taxable year and as if, on the date of the filing of the claim for refund, there was a defect in replacement, three years remain before the expiration of the periods of limitation upon assessment or the filing of claim for refund for the taxable year. The tax previously determined shall be ascertained in accordance with the method provided by section 22 (d) and (e), and the amount to be assessed and collected under this paragraph, in the same manner as if it were a deficiency or to be credited or refunded in the same manner as if it were a deficiency or an overpayment, as the case may be, for such taxable year and as if the aggregate cost of such goods over the aggregate cost thereof as reduced solely from the effect of subparagraph (A) of § 29.22 (d)–1 was a deficiency or an overpayment which shall not be diminished by any credit or set-off based upon any item, inclusion, deduction, credit, or other determination resulting from the effect of subparagraph (A) of § 29.22 (d)–1, inclusive, or suit or claim with respect to those goods specified in his application and properly subject to inventory to compute his opening and closing inventories in accordance with the method provided by section 22 (d).

Under this elective inventory method, the taxpayer is permitted to treat those goods remaining on hand at the close of the taxable year as being—

First, included in the opening inventory of the taxable year, in the order of acquisition and to the extent thereof, and

Second, those acquired during the taxable year.

This elective inventory method is not dependent upon the character of the business in which the taxpayer is engaged, or upon the identity or want of identity through commingling of any of the goods on hand, and may be adopted by the taxpayer as of the close of any taxable year.

If the elective inventory method is used by a taxpayer who regularly and consistently uses a method of inventoring on a futures market, matches purchases with sales, then firm purchases and sales contracts (i. e., those not legally subject to cancellation by either party) entered into at a fixed price, then the value of such goods on the date of the filing of such claim for refund, the adjustment is so prevented, the amount of the adjustment authorized by this paragraph shall be limited to the excess of the aggregate cost of such goods over the aggregate cost thereof as reduced solely from the effect of subparagraph (A) of § 29.22 (d)–1, and such amount shall be assessed and collected, or credited or refunded, in the same manner as if it were a deficiency or an overpayment, as the case may be, for such taxable year and as if, on the date of the filing of the claim for refund, there was a defect in replacement, three years remain before the expiration of the periods of limitation upon assessment or the filing of claim for refund for the taxable year. The tax previously determined shall be ascertained in accordance with the method provided by section 22 (d) and (e), and the amount to be assessed and collected under this paragraph, in the same manner as if it were a deficiency or to be credited or refunded in the same manner as if it were a deficiency or an overpayment, as the case may be, for such taxable year and as if the aggregate cost of such goods over the aggregate cost thereof as reduced solely from the effect of subparagraph (A) of § 29.22 (d)–1 was a deficiency or an overpayment which shall not be diminished by any credit or set-off based upon any item, inclusion, deduction, credit, or other determination resulting from the effect of subparagraph (A) of § 29.22 (d)–1, inclusive, or suit or claim with respect to those goods specified in his application and properly subject to inventory to compute his opening and closing inventories in accordance with the method provided by section 22 (d).
§ 29.22 (d)-2 Requirements incident to adoption and use of elective method. The adoption and use of the elective inventory method, as prescribed by section 22 (d) and regulations thereunder, made subject to the following requirements:

(a) The taxpayer shall file an application to use such method specifying, with particularity the goods to which it is to be applied; and

(b) The inventory shall be taken at cost regardless of market values;

(c) Goods of the specified type included in the opening inventory of the taxable year for which the method is first used shall be considered as having been acquired at the same time and at a unit cost equal to the actual cost of the aggregate divided by the number of units on hand; and the aggregate cost of the aggregate shall be determined pursuant to the inventory method employed by the taxpayer under the regulations applicable to the preceding taxable year, with the exception that restoration shall be made with reference to any write-down to market values resulting from the pricing of former inventories;

(d) Goods of the specified type on hand as of the close of the taxable year in excess of what were on hand as of the beginning of the taxable year shall be included in the closing inventory, regardless of identification with specific inventories, at costs determined as follows:

(1) By reference to the actual cost of the goods most recently purchased or produced;

(2) By reference to the actual cost of the goods purchased or produced during the taxable year in order of acquisition;

(3) By application of an average unit cost equal to the aggregate cost of all of the goods purchased or produced throughout the taxable year divided by the total number of units so purchased or produced, the goods reflected in such inventory increase being considered for the purposes of section 22 (d) as having been acquired all at the same time; or

(4) Pursuant to any other proper method which, in the opinion of the Commissioner, clearly reflects income.

Whichever of the several methods of valuing the inventory increase is adopted by the taxpayer and approved by the Commissioner shall be consistently adhered to in all subsequent taxable years so long as the elective inventory method is used by the taxpayer;

Examplc (1). Suppose, a taxpayer has elected to use the elective inventory method for the taxable year 1942 with an opening inventory of 10 units at 10 cents per unit, that it makes 1942 purchases of 9 units as follows:

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<tr>
<td>January</td>
<td>@ 11 @ 11</td>
</tr>
<tr>
<td>April</td>
<td>@ 2 @ 2</td>
</tr>
<tr>
<td>July</td>
<td>@ 3 @ 3</td>
</tr>
<tr>
<td>October</td>
<td>@ 4 @ 4</td>
</tr>
</tbody>
</table>

 Totals: 10 @ 10 = 100

and that it has a 1942 closing inventory of 15 units. This closing inventory, depending upon the taxpayer's method of valuing inventory increases, will be computed as follows:

(a) Most recent purchases—

<table>
<thead>
<tr>
<th>Units</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 @ 10 @ 10</td>
<td></td>
</tr>
<tr>
<td>1 @ 13 @ 13</td>
<td></td>
</tr>
</tbody>
</table>

 Totals: 15 @ 10 = 165

or (b) In order of acquisition—

<table>
<thead>
<tr>
<th>Units</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 @ 10 @ 10</td>
<td></td>
</tr>
<tr>
<td>1 @ 11 @ 11</td>
<td></td>
</tr>
<tr>
<td>2 @ 12 @ 12</td>
<td></td>
</tr>
</tbody>
</table>

 Totals: 15 @ 10 = 165

or (c) At an annual average—

<table>
<thead>
<tr>
<th>Units</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 @ 10 @ 10</td>
<td></td>
</tr>
<tr>
<td>5 @ 13 @ 13</td>
<td></td>
</tr>
</tbody>
</table>

 Totals: 15 @ 10 = 165

Example (2). Suppose, in addition to the facts stated in example (1), that there is a 1943 closing inventory of 23 units, the cost of which is determined as follows:

<table>
<thead>
<tr>
<th>Units</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>2 @ 11 @ 13</td>
<td></td>
</tr>
</tbody>
</table>

 Totals: 13 @ 13 = 165

(c) The taxpayer shall establish to the satisfaction of the Commissioner that the taxpayer, in ascertaining income, profit, or loss for the taxable year for which the elective inventory method is first used or for any subsequent taxable year, for credit purposes or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries, has used any inventory method except the one consistent with that referred to in § 29.22 (d)-1 and requires of the taxpayer a change to a different method for such subsequent taxable year or any taxable year thereafter; and

(b) The records and accounts employed by the taxpayer in keeping his books shall be maintained in conformity with the inventory method referred to in § 29.22 (d)-1; and such records and accounts of books shall be maintained as will enable the Commissioner readily to verify the taxpayer's inventory computations as well as his compliance with these several requirements.

§ 29.22 (d)-3 Time and manner of making election. The elective inventory method may be adopted and used only if the taxpayer files with his return for each taxable year subsequent to his adoption of the elective inventory method, for credit purposes or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries, a statement that the method be used with respect to goods or other than those specified in the tax-
§ 29.23 (d)-4 Adjustments to be made by taxpayer. A taxpayer may not change to the elective method of taking inventories unless, at the time he files his application for the adoption of such method, he agrees to such adjustments incident to the change to or from such method. The Commissioner shall determine the amount of such adjustment, which shall be determined in conformity with the inventory method then in use. In all subsequent taxable years, unleses the use of another method be required by the Commissioner, or authorized by him pursuant to a written application therefor filed with him as provided in § 29.41-2. 

§ 29.22 (d)-5 Revocation of election. An election made to adopt and use the elective inventory method is irrevocable, and the method once adopted shall be used in all subsequent taxable years unless the use of another method be required by the Commissioner, or authorized by him pursuant to a written application therefor filed with him. 

(d) In any event, in conformity with any inventory method to which the taxpayer may change pursuant to application approved by the Commissioner.

§ 19.23 (d)-7 Involuntary liquidation and replacement. If prevailing war conditions beyond the control of the taxpayer should render it necessary to discontinue his elective inventory method during the period of the war for a taxpayer using the elective inventory method to have on hand at the close of the taxable year a stock of merchandise in kind or description like that included in the opening inventory for the year, or in a quantity equal to that of the opening inventory, the resulting inventory decrease, if recorded, shall be allocated to the account of the taxpayer as reflecting an involuntary liquidation subject to replacement. If the taxpayer notifies the Commissioner at the time of filing his income tax return for the taxable year affected, the taxpayer may change, at his election, to a replacement method. The period of the war for a taxpayer using the elective inventory method to have on hand in his closing inventory the quantity equal to that of the opening inventory. See § 14910 of the Code for a comprehensive discussion of the involuntary liquidation concept. 

The election of the taxpayer to treat any inventory decrease suffered during war conditions, such as (i) enemy capture or control of sources of limited foreign supply; (ii) shipping or other transportation shortages; (iii) material shortages resulting from priorities or allocations; (iv) labor shortages; and (v) similar war conditions beyond the control of the taxpayer. A voluntary shift by the taxpayer in the exercise of business judgment, to merchandise which is not exempt from priorities or allocations, or to merchandise processed out of a substantially different kind of raw materials while raw materials of the type originally used are still available will not be considered as involuntary liquidation notwithstanding the fact that such a shift in merchandise stocked was prompted by a shifting market demand attributable to war conditions. The term "involuntary liquidation" presupposes a physical inability to maintain a normal inventory as distinguished from a financial or business disinclination on the part of the taxpayer to do so. 

If the taxpayer would have the involuntary liquidation and replacement provisions applicable with respect to any inventory decrease suffered during any taxable years, he must so elect at the time of filing his income tax return for the taxable year reflecting the decrease. In making such election, the taxpayer shall attach to his return a statement setting forth the following matters: (1) the wish of the taxpayer to invoke the involuntary liquidation and replacement provisions; (2) a detailed list or other identifying description of the items of merchandise claimed to have been subjected to involuntary liquidation and the extent to which replacement is intended; (3) the circumstances relied upon as rendering the taxpayer unable to maintain throughout the taxable year a normal inventory of the items involved; (4) detailed proof of such circumstances to the extent that they may not be the subject matter of common knowledge; and (5) a full description of what efforts were made on the part of the taxpayer to effect replacement during the taxable year and the result of such efforts.

The election of the taxpayer to treat an involuntary decrease of inventory as subject to the replacement adjustments is to be exercised separately for each taxable year reflecting such a decrease, and the election, once exercised with respect to a given year, shall be irrevocable with respect to the particular decrease involved and its prospective replacement, and shall be binding for the year of liquidation, the year of replacement, and all intervening and subsequent years to the extent that such intervening and subsequent years are affected by the adjustments authorized. The ultimate replacement and the resulting adjustment for the year of liquidation may have consequences, among others, in the earnings and profits of intervening years and the inventory accounts of subsequent years. Adjustments are to be made for the intervening and subsequent years consistent with the adjustments made for the year of liquidation.
tated records shall be maintained such that as will enable the Commissioner, in his examination thereto, to verify the extent of the inventory decrease claimed to be involuntary in character and the facts upon which such claim is based. The amount of subsequent increases and decreases, and all other facts material to the replacement adjustment authorized.

Notwithstanding the ultimate purchase price or the cost of production ultimately incurred by him, in fixing the envy replacement cost; the replacement cost shall be included in the closing inventory for the year of replacement and in that of subsequent taxable years, at the inventory cost figure of the merchandise replaced.

The goods reflected in any inventory increase in a year subsequent to a year of involuntary liquidation, to the extent that they constitute items of the kind and description liquidated in prior years, whether or not in a year of involuntary liquidation, shall be deemed, in the order of acquisition, as having been acquired in the closing inventory for the years affected and with respect to inventory computations for the year of liquidation and other taxable years, whether or not in a year of involuntary liquidation, or for some intervening taxable years. The aggregate of such installment payments for the taxable years in which it is received shall be considered an installment payment for the taxable year in which it is received. (In cases where such periodic payments are attributable to property of an estate or property held in trust under the terms of an amount of money or a written instrument, for the purpose of applying the preceding sentence, the portion of a payment of interest under a judgment, decree, or order of a court, and the accrual of income thereon, shall be considered as an installment payment for the taxable year in which it is received.)

In the case of a referee or referee in gross income or capital gains specified in shareholder's comments, see section 58.

In the case of a wife who is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, capital gains (whether or not made at regular intervals) received subsequent to such decree in the gross income of such wife shall be included in the gross income of such wife, and such amounts received as are attributable to property transferred shall be included in the gross income of such husband. This subsection shall not apply to any such periodic payment which the terms of the decree or written instrument specifically state is not includible in the gross income of such husband, or to any installment payment for the purpose of satisfying the decree, instrument, or settlement, to the extent of such sum payable for such support, shall be considered as a payment of interest under a judgment, decree, or order of a court, and the accrual of income thereon, shall be considered as an installment payment for the taxable year in which such periodic payment is received; and the filing of a claim for refund of the amount of the tax previously determined and, without regard to factors affecting the taxable year involved, to the extent that such installment payment for the taxable year of the wife (or if married to the husband during more than 10 years from the date of such decree or instrument, but only to the extent that such installment payment for the taxable year of the wife (or if married to the husband during more than 10 years from the date of such decree or instrument) for the taxable years in which it is received.)

For purposes of the preceding sentence, the portion of a payment of interest under a judgment, decree, or order of a court, and the accrual of income thereon, shall be considered as an installment payment for the taxable year in which such periodic payment is received; and the filing of a claim for refund of the amount of the tax previously determined and, without regard to factors affecting the taxable year involved, to the extent that such installment payment for the taxable year of the wife (or if married to the husband during more than 10 years from the date of such decree or instrument) for the taxable years in which it is received.;
The periodic payments received by the wife attributable to property so transferred and includible in her income are not to be included in the gross income of the husband. See also § 29.171-1 in cases where such periodic payments are attributable to property held in trust.

The purpose and effect of section 22 (k) is to provide that such periodic payments are to be included in the income of the recipient whether or not such payments are made out of the income of such estates or trusts. The purpose and effect of section 22 (k) is to provide that such periodic payments are to be included in the income of the recipient whether or not such payments are made out of the income of such estates or trusts.

Example 1. W sues H for divorce in 1942. The court awards W an antenuptial annuity of $2,500 a year pending the final decree. On September 19, 1942, the court grants W a divorce and awards her $300 a month for permanent alimony. No part of the $2,500 a year temporary alimony received prior to the decree is includable in W's income under section 22 (k), but the $300 a month received during the balance of 1942 by W is includible in her income for 1942. Under section 23 (u), it is essential to include such $300 payments from his income.

Example 2. W files suit for divorce from H. In consideration of the release of all marital rights and not to make public H's financial affairs, W makes a legally binding promise in writing to W and agrees that he will pay W $200 a month, pursuant to the promise thus received by W is includible in her gross income under the provisions of section 22 (k). Under section 23 (u), a deduction of $2,400 from her gross income.

Example 3. H and W enter into an antenuptial agreement, under which, in consideration of H's agreement to release all marital rights (including dower) to W's property, and, in order to provide for W's support and household expenses, H promises to pay W $500 a month for her life. Ten years after their marriage, W sues H for divorce but does not ask for or obtain alimony because of the provision already made for her support in the antenuptial agreement. Likewise, the divorce decree is silent as to such agreement and the receipt of $2,400 is not included in W's income for the taxable year ending December 31, 1941. (As to including such payments in the wife's income, if made by a trust created under the antenuptial agreement, regardless of whether referred to in the decree or a later instrument, see § 29.171-1.)

Section 22 (k) applies only where the legal obligation being discharged arises out of the family or marital relationship in recognition of the general obligation to support, which is made specific by the Instrument or decree. Thus, section 22 (k) does not apply to any periodic payment which is attributable to the repayment by the husband of, for example, a bona fide loan previously made to him by the wife, the satisfaction of which is expressly provided for in the divorce decree as a part of the general settlement between the husband and wife.
Example (1). Under the terms of a divorce decree, H is to pay W $5,000 in four annual installments. No part of the $10,000 is a W's income under section 22 (k) or deductible by H.

Example (2). A divorce decree in 1940 provides that H is to pay W $25,000 a month for the benefit of the wife and children, and the wife may receive the entire amount with the rate of the decree and then $5,000 each year for the next 10 years. Assuming the wife makes her return for the taxable year in which the payment received in 1942, 1943, and 1944 is a periodic payment received in 1942, 1943, and 1944 is a periodic payment under section 22 (k), but only to the extent of $7,500 of the principal sum of $10,000. Thus for such taxable years, only $15,000 of the $20,000 received is includible under section 22 (k) in the wife's income and is deductible by the husband under section 23 (u). For the years 1945-1954, inclusive, the full $5,000 received each year by the wife is includible in her income and is deductible from the husband's income.

Example (3). Under the terms of a separation agreement incident to divorce granted in December 1941, H agrees to pay W $8,000 on the 1st day of each month, beginning with the month after the decree, for 12 years. W makes her return for the taxable year on the calendar year basis while H makes his return on the basis of the fiscal year ending June 30. H makes the payment in a few cases. The payment received on December 31, 1941, pays W $1,500 as an advance payment of installments for the next three months. In the calendar year 1942, H makes no payments at all because of severe financial straits. On January 1, 1942, H inherits $15,000, which he immediately pays to W in satisfaction of his debt. He has also some alimony installments for the last 9 months of 1941 but also his alimony installments for the next 21 months. The results as to H and W are as follows:

As to H: In the calendar year 1942, W received $7,500. Since 10 percent of $72,000 (the palatable principal of $72,000), only $7,200, or $7,500 so received is includible in her income for 1942. For 1943, nothing is includible in her income under section 22 (k). In 1944, W received $15,000. Of this amount $4,500 is in payment of back installments and, therefore, is includible without limitation in her income for 1944. Of the balance of $10,500, only $2,700 is includible in her income for 1944.

As to W: In the calendar year 1942, W received $7,500. Since 10 percent of $72,000 (the palatable principal of $72,000), only $7,200, or $7,500 so received is includible in her income for 1942. For 1943, nothing is includible in her income under section 22 (k). In 1944, W received $15,000. Of this amount $4,500 is in payment of back installments and, therefore, is includible without limitation in her income for 1944. Of the balance of $10,500, only $2,700 is includible in her income for 1944.

(d) Payments for support of minor children. Section 22 (k) does not apply to that part of any periodic payment which, by the terms of the divorce decree, written instrument under section 22 (k), is specifically designated as a sum payable for the support of minor children of the husband. The statute prescribes the treatment of payments received under such agreements where an amount is specifically designated by the decree to be for the support of such children, or the support of their minor children, and the husband pays only $150 to his wife, $100 of which is designated by the decree to be for the support of their minor children, and the amount of the support should be included in the wife's income at the rate specified by the decree.
used in such offices, and the hire of office assistants. Amounts currently expended for books, furniture, and professional instruments and equipment, the useful life of which is short, may be deducted.

§ 29.23 (a)-6 Compensation for personal services. Among the ordinary and necessary expenses paid or incurred in connection with 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 includes whether the services 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) An amount paid in the form of compensation, but not in fact as the purchase price of services, is not deductible.

(2) An ostensible salary paid by a corporation may be a distribution of a dividend or stock. This may occur in the case of a corporation having few shareholders, practically all of whom draw salaries. If in such a case the salaries are in excess of those ordinarily paid for similar services, and the excessive payments correspond or bear a close relationship to the stock holdings of the officers or employees, it would seem likely that the salaries are not paid wholly for services rendered, but that excessive payments are a distribution of earnings upon the stock. (2) An ostensible salary may be in part payment for property. This may occur, for example, when 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.

(3) The form or method of fixing compensation is not decisive as to deductibility. While any form of contingent compensation involves 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 applicable to compensation paid at a fixed rate. Generally speaking, if contingent compensation is paid pursuant to a free bargain between the employer and the individual made before the services are rendered, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid.

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

§ 29.23 (a)-7 Treatment of excessive compensation. The income tax liability of the recipient in respect of an amount ostensibly paid to him as compensation, but not allowed to be deducted as such by the payor, will be reduced to the extent of the circumstances of each case. Thus, in the case of excessive payments by corporations, if such payments correspond or bear a close relationship to stock holdings, and are found to be in addition for earnings or profits, the excessive payments will be treated as a dividend. If such payments constitute payment for property, they should be treated by the payor as a capital expenditure and by the recipient as part of the purchase price. In the absence of evidence to justify other treatment, excessive payments for salaries or other compensation for personal services will be included in gross income of the recipient and subjected to both normal tax and surtax.

§ 29.23 (a)-8 Bonuses to employees. Bonuses to employees will constitute allowable deductions from gross income only if they are paid in good faith and as additional compensation for the services actually rendered by the employees, provided such payments, when added to the stipulated salary, do not exceed a reasonable compensation for the services rendered. It is immaterial whether such bonuses are paid in cash or in kind or partly in cash and partly in kind. Donations made to employees and others, which do not have in them the element of compensation or are in excess of reasonable compensation for services, are not deductible from gross income.

§ 29.23 (a)-9 Pensions; compensation for injuries. Amounts paid by a taxpayer for pensions to retired employees or to their families or others dependent upon them, or on account of injuries received by employees and lump-sum amounts paid or accrued as compensation for injuries, are proper deductions as ordinary and necessary expenses. Such deductions are limited to the amount actually compensated for suffering or otherwise. 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. As to deductions for payments to employees' pension trusts, see section 23 (p).

§ 29.23 (a)-10 Rentals. If a leasehold is acquired for business purposes take as a deduction in his return an aliquot part of such sum each year, based on the number of years the lease has to run. Taxes paid by a tenant to or for a landlord for business property are additional rent and constitute a deductible item to the tenant and taxable income to the landlord, the amount of the tax being deductible by the latter. The cost borne by a lessee in erecting buildings or making permanent improvements on ground of which he is lessee is held to be a capital investment and not deductible as a business expense. To order to return to such taxpayer his investment of capital, an annual deducti
tion may be made from gross income of an amount equal to the total cost of such improvements or property over the number of years remaining of the term of lease, and such deduction shall be in lieu of a deduction for depreciation. If the remainder of the term of lease is greater than the probable life of the buildings erected, or of the improvements made, this deduction shall take the form of an allowance for depreciation.

In cases in which the lease contains an unexpired option of renewal, the matter of spreading such depreciation or amortization over the term of the original lease, together with the renewal period or periods, depends upon the facts in the particular case. As a general rule, unless the lease has been renewed or the facts show with reasonable certainty that the lease will be renewed, the cost or other basis of the lease or the cost of improvements shall be spread only over the number of years the lease has to run, without taking into account any right of renewal. However, if the taxpayer for any taxable year ending prior to December 31, 1930, has been allowed such depreciation or amortization on the basis of spreading the cost or other basis of such lease or improvements over the number of years the lease has to run, and such taxable year has been closed on that basis, and the tax for that year has to run, including any exercised or unexercised option of renewal, the taxpayer may deduct such depreciation or amortization as an allowable deduction as an item of the cost of property, or of the improvements made, on the basis of spreading such depreciation or amortization over the term of the original lease, together with the renewal period if properly elected, or of the improvements made, this deduction shall take the form of an allowance for depreciation.

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 deducted. The cost of feeding and raising live stock may be treated as an expense deduction, in so far as such feeding and raising is necessary to the business of farming, 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 time of harvest, expenses deducted may, with the consent of the Commissioner (see § 29.41-2), be determined upon the crop basis, and such deductions must be taken in the year in which the crop from which the charge has been realized. The cost of farm machinery, equipment, and farm buildings represents a capital investment and is not an allowable deduction as an item of the cost of property, or of the improvements made, in the development of farms, orchards, and ranches prior to the time when the productive state is reached may be regarded as investments of capital. Amounts expended in purchasing work, breeding, or dairy animals are regarded as investments of capital, and may be depreciated unless such animals are included in an inventory in accordance with § 29.22 (a-7). The purchase price of an automobile, even when wholly used in carrying on farming operations, is not deductible as an expense; if used partly for business purposes and partly for the personal 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 attributable to business purposes is deductible as a necessary expense. If a farm is operated for recreation or pleasure and not on a commercial basis, and if the expenses incurred in connection with the farm are in excess of the receipts therefrom, the entire receipts from the sale of products may be ignored in rendering a return of income, and the expenses incurred, being personal expenses, will not constitute allowable deductions. (See also §§ 29.22 (a-7), 29.23 (e)-5, and 29.23 (d)-10.)

§ 29.23 (a-12) Depositors' guaranty fund. Banking corporations which pursuant to the laws of the States in which they are licensed to do business, 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 depositors' guaranty fund, 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 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; 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 on demand by law and upon demand of the proper State officers.

§ 29.23 (a-13) Corporate contributions. No deduction is allowed under section 23 (a) for a contribution or gift by a corporation if any part thereof is deductible under section 23 (q). Thus, for example, if a corporation makes a contribution of $5,000, only $500 of which is deductible under section 23 (q) (whether because of the 5 percent limitation or requirement of actual payment, or both), no deduction is allowable under section 23 (a) for the $4,500.

The limitations provided in section 23 (a) (1) and this section apply only to payments which are in fact contributions or gifts to organizations described in section 23 (q). For example, payments by a street railway corporation to a local hospital (which is a charitable organization within the meaning of section 23 (q)) in consideration of a binding obligation on the part of the hospital to provide hospital services and facilities for the corporation's employees are not contributions or gifts within the meaning of section 23 (q) and may be deductible under section 23 (a) (1). Limitations of that section are otherwise satisfied.

Donations to organizations other than those described in section 23 (q) which bear a direct relationship to the corporation's business and are regarded as a reasonable expectation of a financial return commensurate with the amount of the donation may constitute allowable deductions as business expenses. For example, a corporation may donate a sum of money to an organization (of a class not referred to in section 23 (q)) intending to hold a convention in the city in which it operates, with a reasonable expectation that the holding of such convention will augment its income through a greater number of people using its cars.

§ 29.23, (a-14) Expenditures for advertising or promotion of good will. A corporation has, for the purpose of computing its excess profits tax, elected under section 733 to charge to capital account expenditures for advertising or promotion of goodwill which may be capitalized as capital investments and which were devoted for taxable years beginning after December 31, 1933, and prior to January 1, 1940, may not deduct similar expenditures for the taxable year. Such a taxpayer has the burden of proving that expenditures for advertising or the promotion of goodwill which it seeks to deduct for such later taxable years may not be regarded as capital investments under the provisions of the regulations prescribed under section 733. For rules for determining what expenditures for advertising or the promotion of good will may be regarded as capital investments, and for information required to be submitted with respect to such expenditures, see § 30.733-2 of this chapter.

§ 29.23 (a-15) Nontrade or nonbusiness expenses.—(a) In general. Subject to the qualifications and limitations in paragraphs (a) (2) and (3) of this section, an expense may be deducted under section 23 (a) (2) only upon the condition that:
 SECTION 24. Section 24 (a) (2) require that the property will be sold at a profit or will otherwise be productive of income. The expenses incurred in connection with the sale of such property are deductible, even though the taxpayer makes efforts to sell the property but does not succeed in converting it to income-producing purposes, and even though the property is not occupied by the taxpayer as a residence, unless prior to the time that such expenses are incurred the property has been rented or otherwise appropriated to income-producing purposes by some other person, or to the beneficiaries, or in conserving the assets of ultimate distribution to the parties entitled thereto, are deductible under this section. Ordinary expenses such as expenses in securing rents on property in the estate of the decedent, or for collecting interest or dividends on securities in that estate, or which are paid or incurred during the taxable year for the management, conservation, or maintenance of property in the estate of the decedent held for the production of income, or otherwise, which are paid or incurred during the taxable year by an administrator or executor for the production or collection of income which, if and when realized, must be reported by the estate for income tax purposes, such as expenses for insurance or repairs, or expenditures for a similar nature, are deductible under this section at the option of the taxpayer notwithstanding any of the provisions of chapter 1.

The ordinary expenditures of administration incurred in a receivership or bankruptcy proceeding are not deductible. Such expenditures include expenditures incurred in the performance of the ordinary duties of a receiver or trustee in bankruptcy, as, for example, fees paid to the attorney for the petitioning creditors, fees paid to the appraisers and other expenditures which are made in connection with the proceeding and which look toward the collection of the assets and their preservation pending ultimate distribution to the parties entitled thereto.

Reasonable amounts paid or incurred by a trustee on account of trustees' fees and other expenses which are ordinary and necessary in connection with the production of income or with the management, conservation,
FEDERAL REGISTER, Wednesday, November 3, 1913

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or maintenance of trust property held for the production of income are deductible, notwithstanding that the trust is not engaged in a business.

Reasonable amounts paid or incurred for the services of a guardian or committee for a ward or minor, and other expenses of guardians and committees which are ordinary and necessary, in connection with the production or collection of income inuring to the ward or minor, or in connection with the management, conservation, or maintenance of property held for the production of income, belonging to the ward or minor, are deductible.

It is immaterial whether the expenses of fiduciaries are paid from the corpus of the estate or from income. Expenses derive their character not from the fund from which they are paid, but from the purposes for which they are incurred.

Expenditures incurred in defending or asserting one's rights to property, in recovering the property, constitute a part of the cost of the property and are not deductible expenses. Attorneys' fees paid in a suit to quiet title to lands are not deductible; but if the suit is also to collect accrued rents for the production of income, the portion of such fees which is deductible which is properly allocable to the services rendered in collecting such rents. Expenditures incurred in protecting or asserting one's rights to property of a declaratory or legislative character, or in connection with the administration of a testamentary trust, are not deductible expenses. Expenditures incurred for the purpose of preparing tax returns (except to the extent such returns relate to taxes on property held for the production of income), for the purpose of recovering taxes (other than recoveries required to be included in income), or for the purpose of resisting a proposed additional assessment of taxes (other than on property held for the production of income) are not deductible expenses under this section, except that part thereof which the taxpayer clearly shows to be properly allocable to the recovery of interests required to be included in income.

The deduction of an item otherwise allowable under section 23 (a) (2) will not be disallowed simply because the taxpayer also had an election under chapter 1 to treat it as a capital expenditure, rather than to deduct it as an expense. (See section 28 (a) (7).) Where, however, the property is treated only as a capital expenditure or where it was properly so treated under an option granted in chapter 1, no deduction is allowable under this section; and this is true regardless of whether any basis adjustment is allowed under section 113.

(c) The provisions of section 23 (a) (2) are not intended in any way to disallow expenditures which would otherwise be allowable under section 23 (a) (1) of the regulations applicable therefor, or under any other section of the Internal Revenue Code or the regulations applicable thereunder. Double deductions are not permitted. Amounts deducted under one provision of the Code cannot again be deducted under any other provision thereof.

§ 29.23 (a)–16 Wage and salary payments in contravention of wage and salary limitations applicable thereto. In any case in which a wage or salary payment, for which a deduction would otherwise be allowable, is determined by the Secretary of Agriculture, or by the Commissioner to have been made in contravention of the Act of October 2, 1942 (Public Law 728, 77th Congress), entitled "An Act to amend the Emergency Price Control Act of 1942, to aid in preventing inflation, and for other purposes," as amended by the Public Debt Act of 1943 (Public Law 34, 78th Congress), or of the regulations, orders, or rulings promulgated thereunder, the amount of such payment shall be disallowed as a deduction. Such a payment will not be allowed for this purpose notwithstanding that the same payment is also disallowed (1) for the purpose of determining costs or expenses of an employer for the purpose of some other law or regulation, either hereinafter or hereafter promulgated, including the Emergency Price Control Act of 1942, or the maximum price regulation thereof; or (2) for the purpose of determining costs or expenses under any contract made by or on behalf of the employer with a government or government agency or authority.

(b) Amount of illegal wage or salary payment not deductible—(1) Unauthorized wage or salary increases. In the case of a wage or salary increased in contravention of the Act of October 2, 1942 (Public Law 728, 77th Congress), or of the regulations, rulings, or orders referred to under paragraph (a) of this section, the amount which is not to be allowed as a deduction under this section is the amount of the wage or salary actually paid or accrued by the employer at the increased rate and not merely an amount representing the increase in such wage or salary. Thus, if, for example, on November 1, 1942, a weekly salary of $100 or a wage rate of $2 an hour is unjustifiably increased for the remainder of the calendar year 1942 to $50 or $1.50, respectively, the deduction of such increased salary or wage is disallowed because such increased salary or wage is not deductible. In such case, the deduction otherwise allowable as a deduction under this section is the total weekly amounts of $90 or the total hourly amounts of $1.50, as the case may be.

§ 29.23 (b)–1 Interest. Interest paid or accrued within the year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is exempt from the taxes imposed by this chapter, may be deducted from the taxes imposed by this chapter.

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 indebtedness. Payments of Maryland or Pennsylvania ground rents are deductible as interest if the ground rent is redeemable, but are treated as rent if the ground rent is irredeemable and in such case are deductible only to the extent they constitute a proper business expense. Interest calculated for cost-keeping or other business purposes on funds or surplus invested in the business which does not represent a charge arising under an interest-bearing obligation, is not an allowable deduction from gross income. Interest payable as municipal bonds, dividends is an allowable deduction. So-called interest on preferred stock, which is in reality a dividend thereon, cannot be deducted in computing net income. (See § 29.13 (b)–17.)

Interest paid within the year on deposits such as interest paid on moneys received for in-
vested and secured by interest-bearing certificates of indebtedness issued by such bank or loan or trust company may be deducted from gross income. As to other amounts of interest not deductible under section 23 (b), see section 24 (c).

§ 29.23 (c)-1 Taxes—(a) In general. Subject to the exceptions stated in this section and §§ 29.23 (c)-2 and 29.23 (c)-3, taxes imposed by the States, any State or Territory, or political subdivision of either, possessions of the United States, or foreign countries, are deductible from gross income for the year in which paid or accrued (see section 42 (3) of taxes). Inheritance, legacies, succession, and gift taxes and Federal income taxes are not deductible from gross income. *Income, war-profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States are deductible from gross income in cases where the taxpayer does not choose to take to any extent for the taxable year the benefits of section 131 (relating to credit for taxes of foreign countries or possessions of the United States). See generally §§ 29.131-1 to 29.131-8, inclusive, as to tax credits.

Postage is not a tax. Amounts paid to States or Territories under secured debts laws in order to render securities tax exempt are deductible. Automobile license fees are ordinary taxes. In general taxes are deductible only by the person upon whom they are imposed. As to tax paid at the source on interest from tax-free government bonds, see section 143 (a) (3).

§ 29.23 (c)-2 Federal duties and excise taxes. Import or tariff duties paid to the proper authority for duties and business, which are payable as 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 cannot be separately deducted. (See § 29.23 (a)-1.)

§ 29.23 (c)-3 Taxes for local benefits. So-called taxes, more properly assessments, paid for local benefits, such as street, sewers, and public 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 which 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 real property taxes deductible are those levied for the general public welfare by the proper taxing authorities at a like rate against all property in the territory over which such authorities have jurisdiction. Assessments under the statutes of California relating to irrigation and of Iowa and the United States or Territories under secured debts laws in order to render securities tax exempt in the case of taxes imposed upon persons engaged in selling tangible personal property at retail, which is measured by the gross receipts for furnishing such services, it is presumed that the amount of the tax is separately stated at the time paid by the purchaser. As used in this section the term "sales tax" means a tax imposed by any State, Territory, District, or possession of the United States, or any political subdivision thereof, upon persons engaged in selling tangible personal property at retail, which is measured by the gross sales price or the gross receipts from the sale or which is a stated sum per unit of such property sold, or upon persons engaged in furnishing services at retail, which is measured by the gross receipts for furnishing such services. If the amount of such tax is separately stated, then to the extent that the amount so stated is paid by the purchaser (otherwise than on the basis of the seller's trade or business) to such person such amount shall be allowed as a deduction in computing the net income of such purchaser as if such amount constituted a tax imposed upon and paid by such purchaser.

*Income, war-profits, and excess-profits taxes imposed by the authority of the United States, provided the tax is measured by the gross receipts for furnishing services at retail, which is measured by the gross receipts for furnishing such services.
A loss on the sale of residential property purchased or constructed by the taxpayer for his personal residence and so used by him up to the time of the sale is not deductible. Nevertheless, if the property so purchased or constructed is prior to its sale rented or otherwise appropriately related to income-producing purposes and is used for such purposes up to the time of its sale, a sale of the property, computed as provided in section 111, is subject to the limitations provided in section 117, an allowable deduction in an amount not to exceed the decrease in the amount realized upon the property at the time it was appropriately related to income-producing purposes (with proper adjustment for depreciation) over the amount realized from the sale.

Example (1). Residential property was purchased by a taxpayer in 1932 for use as his personal residence, the cost of $18,000, of which $15,000 was allocable to the building. The property was so used by the taxpayer until January 1, 1939. From that date to January 1, 1939, a tenant occupied the building and paid rent of $2,000, of which $1,200 was allocable to the building. The building had an estimated life of 20 years on January 1, 1939. The property was sold on January 1, 1942, for $10,000. The loss from the sale allowable as a deduction, except as limited by section 117, is $4,200, computed as follows:

Cost of property in 1932...$25,000
Less depreciation allowed (not less than amount allowable) in respect of the building (depreciation for 8 years at 8 percent based on $18,000, value of building when converted to business use) 1,600
Selling price of property 10,000

Loss computed as provided in section 111...2,600

Value of property at time it was rented on January 1, 1939...23,000
Less proper adjustment for depreciation...1,600

Selling price of property...10,000

Portion of $7,000 loss which is deductible except as limited by section 117...4,200

Example (2). If, under the circumstances set forth in example (1), the property had been purchased at a cost of $20,000, of which $10,000 was allocable to the building, but thereafter the facts and circumstances of the case, the deductible loss, except as limited by section 117, is $9,000, computed as follows:

Cost of property in 1932...$20,000
Less depreciation allowed (not less than amount allowable) in respect of the building (depreciation for 8 years at 8 percent based on $10,000, cost of building) 1,500
Selling price of property...10,000

Loss computed as provided in section 111...9,000

Deductible loss...5,000

Section 29.23 (e)–2

Voluntary removal of buildings. Loss due to the voluntary removal or demolition of old buildings, the scrapping of old machinery, equipment, etc., is deductible in the year when such improvements is deductible from gross income. When a taxpayer buys real estate upon which is located a building, which he proceeds to raze with a view to erecting 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.
the group have been retired. In order to account properly for such retirement, the entire basis of all assets retired, adjusted for salvage, will be charged to the depletion reserve account, which will enable the full cost or other basis of the property to be recovered.

In cases in which depreciable property is disposed of due to causes other than exhaustion, wear and tear, and normal obsolescence, but otherwise than normal, or sale, a deduc-
tion for the difference between the basis of the property (adjusted as provided in section 115 (b) and §§ 28.113 (a) (14)–4, and 28.113 (b) (1)–1 to 28.113 (b) (3)–2, inclusive) and its salvage value and/or amount realized upon its disposition may be allowed subject to the limitations provided in the Internal Revenue Code upon deductions for losses, but only if it is clearly evident that such disposition was not contemplated in the rate of depreciation.

In the case of classified accounts, if it is the consistent practice of the taxpayer to base the rate of depreciation on the expected life of the longest lived asset contained in the account, or in the case of single items, if the rate of depreciation is based on the maximum expected life of the asset, a deduction for the basis of the asset (adjusted as provided in section 115 (b) and §§ 28.113 (a) (14)–4, and 28.113 (b) (1)–1 to 28.113 (b) (3)–2, inclusive) less its salvage value is allowable upon its retirement. (See §§ 29.23 (f)–1 to 29.23 (f)–10, inclusive.)

§ 29.23 (e)–(4) Shrinkage in value of stocks. A person possessing stock of a corporation cannot deduct from gross income any amount claimed as a loss merely on account of shrinkage in value of such stock through fluctuation of the market or otherwise. The loss allowable in such cases is that actually sustained when the stock is disposed of. If stock of a corporation becomes worthless, its cost or other basis as determined and adjusted under section 115 and §§ 28.113 (a) (14)–4, and 28.113 (b) (1)–1 to 28.113 (b) (3)–2, inclusive is deductible by the owner for the taxable year in which the stock became worthless, provided a satisfactory showing is made of its worthlessness. Federal or State authorities incident to the regulation of banks and certain other corporations may require that stock be charged off as worthless or written down to a nominal value. If, in any such case, the basis of the retirement is the worthlessness of the stock, such charging off or writing down is due to market fluctuations, or if no reasonable attempt has been made to determine worthlessness, no deduction for income tax purposes, be considered prima facie evidence of worthlessness; but if the charging off or writing down is due to market fluctuations, or if no reasonable attempt has been made to determine worthlessness, no deduction for income tax purposes, be considered prima facie evidence of worthlessness; but if the charging off or writing down is due to market fluctuations, or if no reasonable attempt has been made to determine worthlessness, no deduction for income tax purposes, be considered prima facie evidence of worthlessness. For limitations on deductions for losses from sales or exchanges of capital assets generally, including stocks and bonds, see section 117.

§ 29.23 (e)–(5) Losses of farmers. Losses incurred in the operation of farms as business enterprises are deductible from gross income. If farm products are held for marketable markets, no deduction on account of shrinkage in weight or physical value or by reason of deterioration in storage shall be allowed, except as such shrinkage may be reflected in a reduction of the inventory and otherwise be determined. The total loss by frost, storm, flood, or fire of a prospective crop is not a deductible loss in computing net income. A farmer, engaged in raising and selling such crops as corn, wheat, oats, cotton, hemp, tobacco, or any other crop of a like nature, which has been deducted as an allowance for insurance or otherwise, may be claimed as a loss. If reimbursement is made by insurance or otherwise to the owner of the property in respect of which a loss was claimed for a prior year, the amount received shall be reported as income for the year in which reimbursement is made. The cost of any feed, purchase, or care which has been deducted as an expense of operation shall not be included as part of the cost of the stock for the purpose of ascertaining the amount of depreciation allowable. If gross income is ascertained by inventories, no deduction can be made for livestock or products lost during the year, whether purchased for resale or produced on the farm. The cost of stock killed or other property destroyed in respect of which a loss was claimed for a prior year, the amount received shall be reported as income for the year in which reimbursement is made. The cost of any feed, purchase, or care which has been deducted as an expense of operation shall not be included as part of the cost of the stock for the purpose of ascertaining the amount of depreciation allowable. If gross income is ascertained by inventories, no deduction can be made for livestock or products lost during the year, whether purchased for resale or produced on the farm. The cost of stock killed or other property destroyed in respect of which a loss was claimed for a prior year, the amount received shall be reported as income for the year in which reimbursement is made. The cost of any feed, purchase, or care which has been deducted as an expense of operation shall not be included as part of the cost of the stock for the purpose of ascertaining the amount of depreciation allowable. If gross income is ascertained by inventories, no deduction can be made for livestock or products lost during the year, whether purchased for resale or produced on the farm.

§ 29.23 (f)–1 Losses by corporations. Losses sustained by domestic corporations during the taxable year and not compensated for by insurance or otherwise are deductible in so far as not prohibited or limited by sections 29 (g), 23 (h), 24 (b), 112, 117, 118, and 251. The provisions of §§ 29.23 (e)–1 to 29.23 (f)–1 inclusive, and paragraphs 1 and 2 are general and applicable to corporations as well as individuals. See section 232 as to deductions by foreign corporations. For special provisions with respect to loss sustained by domestic corporations, see section 127.

[Sec. 23. Deductions from gross income—

as amended by secs. 211 (a), 224, Rev. Act 1913; secs. 301, 306 (b), 2d Rev. Act 1914; sec. 10 (a), Revenue Acts of Amendments 1941; sec. 202 (a), Rev. Act 1941; secs. 105 (c), 120 (b), 121 (a) (c), 122, 123 (a), 124 (a), 125, 126 (a), 127 (a) (c), 129, 134 (d), 138 (b), 165 (b), Rev. Act 1943.)

[In computing net income there shall be allowed as deductions:]

(g) Capital losses—(1) Limitation. Losses sustained during the taxable year from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117.

(2) Securities becoming worthless. If any securities (as defined in paragraph (3) of this subsection) become worthless during the taxable year, the loss resulting from their sale for less than their cost shall be allowed as a loss subject to the limitations provided in paragraph (1) of this subsection.

(3) Definition of securities. As used in this paragraph (3) the term "securities" means (A) shares of stock in a corporation, and (B) rights to subscribe for or receive such shares.

(4) Stock in affiliated corporation. For the purpose of this paragraph (3) stock in an affiliated corporation shall be deemed to be affiliated with the taxpayer only if:

(A) At least 85 percent of each class of its stock is owned directly by the taxpayer; and

(B) More than 90 percent of the aggregate of its gross incomes for all taxable years has been from sources other than royalties, rents, dividends, interest, annuity refunds, sales or exchanges of stocks and securities.

(c) The taxpayer is a domestic corporation.

§ 29.23 (g)–1 Capital losses. Section 23 (g) provides in effect that deductions allowed to individuals under section 23 (e) and to corporations under section 23 (f) for losses sustained on the sale or exchange of a capital asset shall be limited in amount to the extent provided in section 117. Losses sustained by virtue of securities becoming worthless during the taxable year are, under section 23 (g), made subject to the limitations provided in section 117 with respect to sales or exchanges, provided the securities are "capital assets" as that term is defined in § 29.117 (a)–1. For purposes of computing the net income of any taxpayer, such losses are to be considered as being sustained from the sale or exchange of such securities. When the basis of the security on the last day of the taxable year, irrespective of when during the taxable year such securities actually became worthless. Section 23 (g) does not apply to securities which

So in original. "As used in paragraph (2) of this subsection" evidently intended.
are deemed destroyed or seized under section 23 of the Revenue Act of 1942. As used in section 23 (g) and this section the term "securities" means shares of stock in a domestic or foreign corporation and rights to subscribe for or to purchase such stock or such rights at a price adolesed, including options or calls upon such stock or such rights, for not more than Six months, and such options or calls shall be considered as a capital loss for the year of such sale or exchange. Provided, however, that such option or call shall be taken into account in computing income under section 23 (g). (c) The taxpayer owns directly at least 95 percent of each class of the stock of such corporation, and (d) More than 50 percent of the aggregate of the gross incomes of such corporation for all the taxable years during which the deduction was computed, have been from sources other than royalties, rents, dividends, interest, annuities, or gains from sales or exchanges of stocks and securities, and all of such gross incomes have been considered as a long-term capital loss under section 117. (See also section 117 (d).) Since Corporation B is deemed to be affiliated with Corporation S for the purposes of section 23 (g), the stock of Corporation B is not a "capital asset" in the hands of Corporation S for the purposes of section 117 (d) and is a business debt for the purposes of section 117 (e). Consequently, in computing the net income of Corporation S for the year, all losses upon such stock, under section 117 (e), shall be deducted as an ordinary loss and will not be subject to the provisions of section 23 (g) or section 117.

With respect to losses on bonds and similar securities of section 23 (k) (5) of a corporation affiliated with the taxpayer, as provided in such section, see § 22.93 (b)–1.

[Sec. 23. Deductions from gains recognized—as amended by secs. 211 (a), 211, Rev. Act 1943; sec. 10 (b), Excess Profits Tax Amendments 1942; sec. 10 (b), Rev. Act 1941; sec. 10 (b), Rev. Act 1940; sec. 10 (b), Rev. Act 1939; rec. 301, 301 (b), 2d ed. Act 1942; rec. 301, 301 (b), 2d ed. Act 1941; sec. 10 (b), Excess Profits Tax Amendments 1941; sec. 10 (b), Excess Profits Tax Amendments 1940; sec. 10 (b), Excess Profits Tax Amendments 1939; sec. 10 (b), Excess Profits Tax Amendments 1938; sec. 10 (b), Excess Profits Tax Amendments 1937.] In computing net income there shall be allowed as deductions: (a) Wagering losses. Losses from wagering transactions, whether to or from the extent of the gains from such transactions. § 22.93 (b)–1 Wagering losses. Deductions for losses from wagering transactions are allowed only to the extent of the gains from such transactions. In the case of a husband and wife making a joint return, the combined losses of the spouses as a result of wagering transactions shall be allowed to the extent of the combined gains of the spouses from such transactions.

[Sec. 23. Domestie manufacturing corporation—as amended by secs. 211 (a), 211, Rev. Act 1943; rec. 301, 301 (b), 2d ed. Act 1942; rec. 301, 301 (b), 2d ed. Act 1941; sec. 10 (b), Excess Profits Tax Amendments 1941; sec. 10 (b), Excess Profits Tax Amendments 1940; sec. 10 (b), Excess Profits Tax Amendments 1939; sec. 10 (b), Excess Profits Tax Amendments 1938; sec. 10 (b), Excess Profits Tax Amendments 1937.] In computing net income there shall be allowed as deductions: (b) Basis for determining loss. The basis for determining the amount of the deduction for losses sustained, to be allowed under subsection (a) or (f), and for bad debts, to be allowed under subsection (h) shall be the adjusted basis provided in section 113 (b) for determining the loss from the sale or other disposition of property. § 22.93 (d)–1 Basis for determining loss. The basis for determining the amount of the deduction for losses allowed to individuals under section 23 (a) and to corporations under section 23 (f) or of the amount of the deduction for bad debts allowed to both individuals and corporations under section 23 (c), is the same as is provided in section 113 for determining the loss from the sale or other disposition of property. Proper adjustments must be made in each case for any capital losses, or other item properly chargeable to capital account, and for depreciation, obsolescence, amortization, or depletion. (See section 113 (b) and §§ 22.93 (b)–1 to 22.93 (d)–1.)

[Sec. 23. Deductions from gross income—as amended by secs. 211 (a), 211, Rev. Act 1943; rec. 301, 301 (b), 2d ed. Act 1942; rec. 301, 301 (b), 2d ed. Act 1941; sec. 10 (b), Excess Profits Tax Amendments 1941; sec. 10 (b), Rev. Act 1941; sec. 10 (b), Rev. Act 1940; sec. 10 (b), Excess Profits Tax Amendments 1939; sec. 10 (b), Excess Profits Tax Amendments 1938; sec. 10 (b), Excess Profits Tax Amendments 1937.] In computing net income there shall be allowed as deductions: (a) at least 65 percent of each class of such corporation's stock is owned directly by the taxpayer; and (b) more than 60 percent of the aggregate of its gross incomes for all taxable years has been from sources other than royalties, rents, dividends, interest or annuities; or gains from sales or exchanges of stock and securities, and (c) the taxpayer is a domestic manufacturing corporation, and (d) the taxpayer is a domestic manufacturing corporation which makes its income tax return on the calendar year basis, owns 100 percent of each class of the stock of Corporation B which it acquired in 1936, Corporation S, a domestic manufacturing corporation which makes its income tax return on the calendar year basis, owns 65 percent of the common stock of Corporation R which it acquired in 1934. It is established that the stock of Corporation B which has from its inception derived all its gross income from manufacturing operations, became worthless in 1936. Since Corporation P does not own directly at least 95 percent of the stock of Corporation B, and therefore neither of section 23 (g) (3) and this section is not affiliated with Corporation B, the stock of such corporation is a capital asset for the purposes of section 117 (d) and under section 23 (g) (5), will be considered to be a loss from the sale or exchange of a capital asset. Since such stock was held for more than six months, such loss shall be considered a long-term capital loss under section 117. (See also section 117 (d).) Since Corporation B is deemed to be affiliated with Corporation S for the purposes of section 23 (g), the stock of Corporation B is not a "capital asset" in the hands of Corporation S for the purposes of section 117 (d) and is a business debt for the purposes of section 117 (e). Consequently, in computing the net income of Corporation S for the year, all losses upon such stock, under section 117 (e), shall be deducted as an ordinary loss and will not be subject to the provisions of section 23 (g) or section 117.

With respect to losses on bonds and similar securities of section 23 (k) (5) of a corporation affiliated with the taxpayer, as provided in such section, see § 22.93 (b)–1.
§ 29.23 (c)–1 Bad debts. (a) Bad debts may be treated in either of two ways:

(1) By a deduction from income in respect of debts which become worthless in whole or in part, or

(2) By a deduction from income of an addition to a reserve for bad debts.

Taxpayers were given a similar option for 1921 to select either of the methods mentioned for treating such debts. (See article 151, Regulations 62.) While as a general rule, the method selected is approved, the Commissioner may permit the use of other methods in cases where the method selected is not approved. Application may be granted for permission to change the method of treating bad debts shall be made at least 30 days prior to the close of the taxable year for which the change is to be effective. (See also §29.23 (k)-5.)

(b) If, from all the surrounding and attending circumstances, the Commissioner is satisfied that a debt is partially worthless, the amount thereof which has become worthless during the taxable year shall be allowed as a deduction in computing net income. Before a taxpayer may deduct a debt in part, he must be able to demonstrate to the satisfaction of the Commissioner the amount thereof which is uncollectible and the part thereof which has become worthless during the taxable year. If a debt becomes wholly worthless during the taxable year, the amount thereof which has not been allowed as a deduction for any prior taxable year shall be allowed as a deduction for the taxable year in which such charge-off takes place. If a taxpayer does not claim a deduction in its return for such a totally or partially worthless debt for the year in which such charge-off takes place, but claims such deduction for the taxable year in which the debt becomes worthless or worthless only in part during the taxable year, as the case may be, no such debt shall be so conclusively presumed to be worthless or worthless only in part, as the case may be, if the amount so charged off is not claimed as a deduction by the taxpayer at the time of filing the return for the taxable year in which the debt becomes worthless or worthless only in part.

(c) Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders of such supervisory officers charge off debts in whole or in part, such debts shall, to the extent charged off during the taxable year, be conclusively presumed to become worthless or worthless only in part during the taxable year.

(d) The provisions of paragraphs (a) and (b) of this section apply to all taxpayers, except that (1) they do not apply in the case of a taxpayer, other than a corporation, with respect to a non-business debt as defined in section 23(6) of the Code; (2) no deduction on account of worthless-ness shall be allowed with respect to any debt of the type enumerated in section 23(7) (c) (5) of the Code which is recoverable only in part; and (3) in the case of taxpayers other than banks as defined in section 104, the term “debts” as used in such subdivisions means obligations to pay fixed or determinable sums of money which are not evidenced by securities as defined in §29.23 (c)–4.

§ 29.23 (c)–2 Examples of bad debts. Worthless debts arising from unpaid wages, salaries, rents, and similar items of taxable income will not be allowed as deductions in computing net income where such items have been included in the return of income for the year for which the deduction as a bad debt is sought to be made, or for 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 a security receivable which becomes worthless 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.

§ 29.23 (k)–3 Uncollectible deficiency upon sale of mortgaged or pledged property. If mortgaged or pledged property is lawfully sold (whether to the creditor or another purchaser) for less than the amount of the debt, and the portion of the indebtedness which has not been paid after such sale is wholly or partially uncollectible, the mortgagee or pledgee may deduct such amount (to the extent that it constitutes capital or represents an item of income from which has been returned by him) as a bad debt for the taxable year in which it has become wholly or partially worthless.

In whole or in part, or

spect of debts which become worthless in whole or in part, such debts shall, to the extent charged off during the taxable year, be conclusively presumed to become worthless or worthless only in part during the taxable year, as the case may be; no such debt shall be so conclusively presumed to be worthless or worthless only in part, as the case may be, if the amount so charged off is not claimed as a deduction by the taxpayer in the return for the taxable year in which the debt becomes worthless or worthless only in part.
under section 23 (k) with respect to a debt evidenced by a security; but in section 23 (k) (3), which is recoverable only in part. Section 23 (k) (2) does not apply to securities which are deemed destroyed or seized under section 23 (l) on account of foreclosures. As used in section 23 (k) (2), the term "security" means a bond, debenture, note, or certificate, or other evidence of indebtedness to pay a fixed or determinable sum of money, which has been issued at any time by a domestic or foreign corporation (including that issued by any government or political subdivision thereof), either in registered form or accompanied by interest coupons.

A bond issued by an individual, if it has become worthless, may be treated as a bad debt. A bond (whether or not a security) of an insolvent corporation secured only by a mortgage from which on foreclosure nothing is realized for the bondholders is regarded as having become worthless not later than the year of the foreclosure sale, and no deduction is allowable in computing a bondholder's income for a subsequent year.

A taxpayer (other than a dealer in bonds or other similar obligations) possessing debts evidenced by bonds or other obligations cannot deduct from gross income any amount merely on account of market fluctuation. If, however, due, for instance, to the financial condition of the debtor, or conditions other than market fluctuations, the taxpayer will recover upon maturity none or only a part of the debt evidenced by the bonds or other similar obligations (which bonds or other obligations are not securities as defined in this section) and he so demonstrates to the satisfaction of the Commissioner, he may deduct in computing the net income the uncollectible part of the debt evidenced by the bonds or other similar obligations (which bonds or other obligations are not securities as defined in this section) and the amount which is deemed a recoverable part of the debt evidenced by the bonds or other similar obligations (which bonds or other obligations are not securities as defined in this section) and the amount which is deemed a recoverable part of the debt evidenced by the bonds or other similar obligations (which bonds or other obligations are not securities as defined in this section).

The application of section 23 (k) (5) to deductions for worthless bonds and similar obligations which are securities may be illustrated by the following examples:

Example (1). On February 4, 1941, A, an individual, who is not a dealer in corporate bonds, purchased bonds of the X Corporation bearing interest coupons payable semiannually, for which he paid $5,000. During the calendar year 1942 (his taxable year) the bonds became worthless. A is entitled to a deduction of $5,000 in computing his net income for the year. The computation of the amount of the deduction is the same as the computation in the example under § 29.23 (k) (1).

Example (2). If the facts in example (1) are the same except that because of the financial condition of the X Corporation the debt evidenced by its bonds became worthless only in part, no deduction is allowable to A under either section 23 (k) (1) or (2) with respect to the recoverable part of the asset.

Under section 23 (k) (5), bonds, debentures, notes, or certificates, or other evidences of indebtedness to pay a fixed or determinable sum of money, issued with interest coupons or in registered form, are not eligible for deduction as a bad debt if the taxpayer, shall not be deemed capital assets of the taxpayer for the purposes of section 23 (k) (2) or as a debt (evidenced by a security) for the purposes of this section, and the provisions of section 23 (k) (1) and of paragraphs (a) and (b) of § 29.23 (k) (1) shall apply with respect to such debts except that no deduction for such debts evidenced by a security is allowable to the taxpayer with respect to any such debt which is recoverable only in part. For the purposes of this section, a corporation is deemed to be affiliated with the taxpayer if the taxpayer owns at least 5 percent of each class of the stock of such corporation, if more than 90 percent of the aggregate of the gross incomes of such corporation for all taxable years has been from sources other than royalties, rents, dividends, interest, or annuities, or gains from the sales or exchanges of stocks and securities and if the taxpayer is a domestic corporation.

§ 29.23 (k) (5). Reserve for bad debts. Taxpayers who have established the reserve method of treating bad debts and maintained proper reserve accounts for bad debts, or who, in accordance with § 29.23 (1)–(5), have computed the reserve for bad debts in lieu of a deduction for specific bad debt items, may establish a reserve for bad debt items.

If a security (as defined in this section) and the amount of the debt evidenced by the security, as defined in this section, becomes worthless within a taxable year, the loss resulting therefrom shall be determined as the excess or inadequacy in the existing reserve (which bonds or other obligations are not securities as defined in this section) and the provisions of this section; and the provisions of this section, a corporation is deemed to be affiliated with the taxpayer if the taxpayer owns at least 5 percent of each class of the stock of such corporation, if more than 90 percent of the aggregate of the gross incomes of such corporation for all taxable years has been from sources other than royalties, rents, dividends, interest, or annuities, or gains from the sales or exchanges of stocks and securities and if the taxpayer is a domestic corporation.

The application of section 23 (k) (5) to deductions for worthless bonds and similar obligations which are securities may be illustrated by the following examples:

Example (1). A sale of the business but retains the claim against B. The claim becomes worthless in A's hands in 1942. A's loss is controlled by the nonbusiness debt provisions. While the original consideration was advanced by A in his trade or business, the loss was not sustained as a proximate incident to the conduct of his trade or business.

To illustrate: A, an individual engaged in the grocery business and who makes his income returns on the calendar year basis, extends credit on an open account to B in 1941.

(1) In 1942 A sells the business but retains the claim against B. The claim becomes worthless in A's hands in 1942. A's loss is controlled by the nonbusiness debt provisions. While the original consideration was advanced by A in his trade or business, the loss was not sustained as a proximate incident to the conduct of his trade or business.

Example (2). If the facts in example (1) are the same except that because of the financial condition of the X Corporation the debt evidenced by its bonds became worthless only in part, no deduction is allowable to A under either section 23 (k) (1) or (2) with respect to the recoverable part of the asset.

Example (3). In 1942 A dies, leaving the business, including the accounts receivable, to his son, C, the taxpayer. The claim against B becomes a liability of D, A's daughter. D's loss is not controlled by the nonbusiness debt provisions. While C did not advance any consideration for the claim or acquire it in connection with the trade or business, the loss was sustained as a proximate incident to the conduct of the trade or business in which he was engaged at the time the debt became worthless.

Example (4). In 1942 A dies, leaving the business to his son, C, but the claim against B to his daughter, D, after the termination of C's debt is one the taxpayer or other similar obligations which are securities, or other evidences of indebtedness to pay a fixed or determinable sum of money, issued with interest coupons or in registered form, are not eligible for deduction as a bad debt if the taxpayer, shall not be deemed capital assets of the taxpayer for the purposes of section 23 (k) (2) or as a debt (evidenced by a security) for the purposes of this section, and the provisions of section 23 (k) (1) and of paragraphs (a) and (b) of § 29.23 (k) (1) shall apply with respect to such debts except that no deduction for such debts evidenced by a security is allowable to the taxpayer with respect to any such debt which is recoverable only in part. For the purposes of this section, a corporation is deemed to be affiliated with the taxpayer if the taxpayer owns at least 5 percent of each class of the stock of such corporation, if more than 90 percent of the aggregate of the gross incomes of such corporation for all taxable years has been from sources other than royalties, rents, dividends, interest, or annuities, or gains from the sales or exchanges of stocks and securities and if the taxpayer is a domestic corporation.

The application of section 23 (k) (5) to deductions for worthless bonds and similar obligations which are securities may be illustrated by the following examples:

Example (1). If the facts in example (1) are the same except that because of the financial condition of the X Corporation the debt evidenced by its bonds became worthless only in part, no deduction is allowable to A under either section 23 (k) (1) or (2) with respect to the recoverable part of the asset.

Example (2). If the facts in example (1) are the same except that because of the financial condition of the X Corporation the debt evidenced by its bonds became worthless only in part, no deduction is allowable to A under either section 23 (k) (1) or (2) with respect to the recoverable part of the asset.

Example (3). In 1942 A dies, leaving the business, including the accounts receivable, to his son, C, the taxpayer. The claim against B becomes a liability of D, A's daughter. D's loss is not controlled by the nonbusiness debt provisions. While C did not advance any consideration for the claim or acquire it in connection with the trade or business, the loss was sustained as a proximate incident to the conduct of the trade or business in which he was engaged at the time the debt became worthless.
The provisions of this section with respect to non-business debts are applicable only to taxable years beginning after December 31, 1942.

§ 29.23 (a)-15 as held by the taxpayer for the production of income. (See sections 23 (m) and 114.) Property kept in repair may, nevertheless, be the subject of a depreciation allowance under § 29.23 (a)-2. The dedication of an allowance for depreciation is limited to property used in the taxpayer's trade or business, or treated under § 29.23 (a)-3 as held by the taxpayer for the production of income, may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The provision for such depreciation is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), so that the amounts so set aside, plus the salvage value, will, at the end of the useful life of the depreciable property, equal the cost or other basis of the property determined in accordance with section 112. Due regard must also be given to expenditures for current upkeep. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall first be made in amounts sufficient to keep the trust corpus intact by retaining such provisions, on the basis of the trust income allocable to the trust, or, in the absence of such provisions, on the basis of the capital sum over units of production. In the case of the acquisition of property in the case of the acquisition on or after March 1, 1919, of a combination of depreciable and nondepreciable property for a lump price, as, for example, buildings and land, the capital sum to be replaced is limited to an amount which bears the same proportion to the lump price as the value of the depreciable property at the time of acquisition bears to the value of the entire property at that time. In the case of property which has been the subject of deductions for amortization under sections 214 (a) and 234 (a) of the Revenue Acts of 1918 and 1921, depreciation deductions will be computed after the close of the amortization period upon the cost or other basis of such property after the amortization allowances have been deducted. No depreciation deduction will be allowed in the case of property which has been amortized to its scrap value and is no longer in use.

§ 29.23 (a)-3 Depreciation of intangible property. The use of which in the trade or business or in the production of income 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 production of income 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 have a finite value in the business or in the production of income for only a limited period, the length of which can be estimated from experience, 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. No deduction for depreciation, including obsolescence, is allowable in respect of goodwill.

§ 29.23 (1) Capital sum recoverable through depreciation allowances. The capital sum to be replaced by depreciation allowances is the cost or other basis of the property for which the allowance is made. (See sections 113 (a) and 114.) To this amount should be added from time to time the cost of improvements, additions, and the like, and 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 through retirement or obsolescence. The amount so added to the cost or other basis of the property for which the allowance is made should be added to the amount of the capital sum over units of production.
tion for depreciation shall be allowed. The deduction for depreciation in respect of any depreciable property for any taxable year shall be limited to such a ratable amount as may reasonably be considered necessary to recover during the remaining useful life of the property the unrecovered cost or other basis. The burden of proof rest upon the taxpayer to sustain the deduction claimed. Therefore, taxpayers must furnish full and complete information with respect to the cost or other basis of the assets in respect of which depreciation is claimed, their age, condition, and remaining useful life, the portion of their cost or other basis which has been recovered through depreciation allowances for prior taxable years, and such other information as the Commissioner may require in substantiation of the deduction claimed.

A taxpayer is not permitted under the law to take advantage in later years of his prior failure to take any depreciation allowance or of his action in taking an allowance plainly inadequate under the known facts in prior years. This paragraph may be illustrated by the following example:

Example. An asset was purchased January 1, 1941, at a cost of $10,000. The useful life of the asset is 10 years. It has no salvage value. Depreciation was deducted and allowed for 1941 to 1943 as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount Allowed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1941</td>
<td>$1,000.00</td>
</tr>
<tr>
<td>1940</td>
<td>$2,000.00</td>
</tr>
<tr>
<td>1939</td>
<td>$2,000.00</td>
</tr>
<tr>
<td>1938</td>
<td>$1,000.00</td>
</tr>
<tr>
<td>1937</td>
<td>$1,000.00</td>
</tr>
</tbody>
</table>

The correct amended reserve as of December 31, 1941, is computed as follows:

<table>
<thead>
<tr>
<th>December 31, 1941</th>
<th>Reserve as of December 31, 1941</th>
</tr>
</thead>
<tbody>
<tr>
<td>1941</td>
<td>$6,666.67</td>
</tr>
<tr>
<td>1940</td>
<td>$2,000.00</td>
</tr>
<tr>
<td>1939</td>
<td>$2,000.00</td>
</tr>
<tr>
<td>1938</td>
<td>$1,000.00</td>
</tr>
<tr>
<td>1937</td>
<td>$1,000.00</td>
</tr>
</tbody>
</table>

Accordingly, the reserve December 31, 1941, as $6,666.67. Depreciation for 1942 and subsequent taxable years is $6666.67, computed as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount Allowed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1942</td>
<td>$10,000.00</td>
</tr>
</tbody>
</table>

| Uncovered cost | $3,333.33 |

§ 29.23 (1)–7 Depreciation of patent or copyright. In computing a depreciation allowance in the case of a patent or copyright, the capital sum to be replaced shall be the cost or other basis of the patent or copyright. The allowance should be computed by an apportionment of the amount over the life of the patent or copyright after the expiration, such proportion of the allowance for depreciation may also 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 be reasonably practicable to submit 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 basic date and the date when it legally expires may be deducted. The fact that depreciation has not been claimed for years does not entitle the taxpayer to deduct in any taxable year a greater amount for depreciation than would otherwise be allowable.

§ 29.23 (1)–8 Depreciation of drawings and models. In a firm or corporation that has incurred expenditures in his business for designs, drawings, patterns, models, or work of an experimental nature calculated to result in improvement of his facilities or his property, a portion of the cost of such assets 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 of a sum set up as an asset except on the sale or other disposition of such asset at a loss or on proof of a total loss thereof.

§ 29.23 (1)–9 Obsolescence. With respect to physical property the whole or any portion of which is clearly shown by the taxpayer as being affected by economic conditions that will result in its being abandoned at a future date prior to the end of its normal useful life, so that depreciation deductions alone are insufficient to return the cost or other basis at the end of its economic term of usefulness, a reasonable deduction for obsolescence, in addition to depreciation, may be allowed in accordance with the facts relating to each item of property claimed in which a claim of obsolescence is made. No deduction for obsolescence will be permitted merely because, in the opinion of a taxpayer, the property is deemed obsolete at some later date. This allowance will be computed and recorded with express reference to specific items, units, or groups of property, each item or unit being considered separately or specifically included in a group or updated with the factors apply. Also, the taxpayer's books shall show the basis of the depreciable property and any adjustments thereto, and, in case where the basis of the property is other than cost, or value on March 1, 1913, or value at date of acquisition (as, for example, if the property was acquired by gift or transfer in trust after December 31, 1932), or through a reorganization or exchange (see especially section 113 (a), the books shall show the data used in ascertaining such basis and the adjustments thereto. If a taxpayer does not desire to have his regular books of account show all of the factors entering into the computation of depreciation allowances, such factors shall be recorded in permanent asset records which shall be kept with and reconciled with the regular books of account.

§ 29.23 (1)–10 Depreciation in 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 real property. A reasonable allowance for depreciation may also be claimed on livestock acquired for work, breeding, or dairy purposes, unless they are included in an inventory used to determine profits in accordance with § 29.22 (a)–(7). Such depreciation should be based on the cost or other basis and the estimated life of the livestock. If such livestock be included in an inventory used to determine no depreciation thereof will be allowed, as the corresponding reduction in their value will be reflected in the inventory. (See also §§ 29.23(a)–11 and 29.23(a)–1.5.)

[Sec. 23. Depreciation from gross income as amended by cols. 211 (a), 224, Rev. Act 1939; cols. 201, 556 (b), 2d Rev. Act 1919; cols. 106, Excess Profits Tax Amendments 1941; cols. 223 (a), Rev. Act 1941; cols. 123 (b), 121 (a) (c), 122, 123 (a), 124 (a), 125, 126 (a), 127 (b) (a), 128, 129 (d), 130 (b), 131 (a) (b), 133 (a) (c), 134 (b), 135 (b), 136 (b), Rev. Act 1944.)

In computing net income there shall be allowed as deductions:

(m) Depreciation. 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; and a reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the advice and consent of the Secretary of the Treasury, in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, thereafter the estimate (but not the basis for depletion) shall be revised and the allowance under this subsection, for subsequent taxable years, shall be based upon such revised estimate. In the case of leases the deductions shall be equitably prorated among the lessee and lessor.

In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the tenant were the owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be ap-
portioned between the income beneficiaries and the trustee in accordance with the per- 
tinent provisions creating the trust, or, in the absence of such provi-
sions, on the basis of the trust income allocable
For percentage depletion allowable under this subsection, see section 114 (b), (3) and (4)
(a) Basis for depreciation and depletion
The basis upon which depletion, exhaustion, 
wear and tear, and obsolescence are to be 
allowed in respect of any property shall be as 
provided in section 116. 
§ 29.23 (m) -1. Depletion of mines, oil 
and gas wells, other natural deposits, 
and timber; depreciation of improve-
ments. Section 23 (m) provides that 
there shall be allowed as a deduction in 
computing net income in the case of 
mines, oil and gas wells, other natural 
deposits, and timber, a reasonable allow-
ance for depletion and for depreciation 
of improvements. Section 114 prescribes 
the bases upon which such allowances 
and depletion are to be allowed. 
Under such provisions, the owner of 
an economic interest in mineral deposits or 
standing timber is entitled to depletion 
deductions. An economic inter-
est is possessed in every case in which the 
taxpayer has acquired, by investment, 
any interest in mineral in place or stand-
ning timber and secures, by any form of 
legal relationship, Income derived from 
the severance and sale of the mineral or 
timber, to which he must look for a re-
turn of his capital. But a person who 
has no capital investment in the mineral 
deposit or standing timber does not pos-
sess an economic interest merely because, 
through a contractual relation to the 
owner, he possesses a mere economic 
ad vant edge derived from production. Thus, 
an agreement between the owner of 
an economic interest and another entitling 
the latter to purchase the product upon 
production or to share in the net income 
derived from severance of such deposits 
does not convey a depleteable economic 
interest. 
The adjusted basis of depreciable 
property is determined through annual 
depreciation deductions. Depreciation 
and depletion deductions on the property 
of a corporation are allowed to the cor-
poration and not to its shareholders. 
(But see § 29.115-6.) The principal 
concerning the apportionment of deple-
tion in the case of property held by 
one person for life with remainder to 
another person and in the case of property 
held in trust are also applicable to deple-
tion. (See § 29.23 (d) -1.) 
When used in these sections (§§ 29.23 
(m) -1 to 29.33 (m) -28, inclusive) cover-
ing depletion and depreciation; 
(a) The term "mineral deposit" is the 
property. Such property is that amount which would 
induce a willing seller to sell and a willing buyer 
to purchase.
(b) A "mineral property" is the 
mineral deposit, the development and plant 
necessary for its extraction, and so much of 
the surface of the land only as is nec-
ecessary for purposes of mineral extrac-
tion. The value of a mineral property is 
the combined value of its component 
parts,
(c) The term "mineral deposit" re-
fers to minerals in place. The cost of a 
mineral deposit is that proportion of the 
total cost of the mineral property which 
the value of the deposit bears to the value of 
the property at the time of its pur-
(d) "Minerals" includes ores of 
the metals, coal, oil, gas, and other non-me-
tallic substances as abrasives, asbestos, 
asphaltum, barytes, borax, building 
stone, cement rock, clay, crushed stone, 
feldspar, fluor spar, fuller's earth, graph-
ite, gravel, gypsum, limestone, magnesite, 
mica, mires, mineral pigments, pest, pet-
ash, precious stones, refractories, rock 
phosphate, salt, sand, silicon, slate, soap-
stone, soda, sulphur, and tale. 
(e) The term "mine" does not include 
oil and gas wells. 
(f) "Gross income from the property," 
as used in section 114 (b), (3) and (4), 
and §§ 29.23 (m) -1 to 29.23 (m) -28, in-
cludes, but is not limited to, which the 
taxpayer sells the crude mineral product 
of the property in the immediate vicin-
ty of the mine or well, but, if the prod-
uct is transported or processed (other 
than by the processes excepted in sub-
section (a)), before sale, it means the representa-
tive market or field price (as of the date of 
sale) of the crude mineral product of like 
quality, whether mineral or nonmetallic, of 
the same or similar kind and grade, and to 
the same market or field price (as of the 
date of sale) of the product sold during the 
current taxable year. If advanced royalties 
have been paid in respect of the property 
in any taxable year ending on or after 
December 31, 1939, the amount exempt 
from "gross income from the property," 
for the current taxable year on account of 
such payments shall be an amount equal 
to the deduction for such taxable year 
taken on account of such payments 
pursuant to § 29.23 (m) -16 (e) 
(g) "Net income of the taxpayer (com-
puted without allowance for depletion) 
from the property," as used in section 
114 (b), (3) and (4) and §§ 29.23 
(m) -1 to 29.23 (m) -28, inclusive, means 
the "gross income from the property," as 
defined in paragraph (f) of this section 
less the allowable deductions attributable 
to the mineral property and to which 
the depletion is claimed and the allowable 
deductions attributable to the processes 
listed in paragraph (f) in so far as they 
relate to the product of such property, 
including overhead and carrying expen-
ses, development costs properly 
charged to expense, depletion, taxes, 
losses sustained, etc., but excluding any 
allowances for depletion. Deductions not 
directly attributable to particular prop-
erties or processes shall be fairly allo-
cated. To illustrate: In cases where the 
taxpayer engages in activities in addi-
tion to mineral extraction bearing the 
processes listed in paragraph (f), deduc-
tions for depletion, taxes, general expen-
ses, and overhead, which cannot be 
directly attributable to any specific activ-
ity, shall be fairly proportioned between 
the mineral extraction and the pro-
cesses listed in paragraph (f) and the 
additional activities, taking into account 
the ratio which the operating expenses 
directly attributable to the mineral 
 extraction and the processes listed in 
paragraph (f) bear to the operating expenses 
directly attributable to the additional
activities. If more than one mineral property is involved, the deductions apportioned to the mineral extraction and the processes listed in paragraph (f) shall, in turn, be fairly apportioned between the several properties, taking into account their relative production.

(h) "Crude mineral product," as used in paragraph (f) of this section, means the products in the form in which it emerges from the mine or well.

(i) "The property," as used in section 114 (b), (2), (3), and (4) and §§ 29.23 (m)-1 to 29.114, inclusive, means the interest owned by the taxpayer in any mineral property. The taxpayer's interest in separate mineral properties is a separate "property"; but, where two or more mineral properties are included in a single tract or parcel of land, the taxpayer's interest in such mineral properties may be considered to be a single "property," provided such treatment is consistently followed.

§ 29.23 (m)-3 Computation of depletion of mines, oil and gas wells, and other natural deposits without reference to discovery value or percentagé depletion.

The basis upon which depletion, other than discovery depletion or percentage depletion, is determined in respect of any property is the basis provided in section 113 (a), adjusted as provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of the property. As used in this section the phrase "gross income from the property," see § 29.23 (m)-1 (m)-1, inclusive, means the gross income from the property excluding income on the cash receipts and disbursements basis. As used in this section the phrase "net income from the property" as used in section 29.23 (m)-8, means the net income from the property computed without allowance for depletion.

§ 29.23 (m)-3 Computation of depletion of mines (other than metal, coal, fluor spar, ball and sagger clay, rock asphalt, or sulphur mines) on basis of discovery value.

The basis upon which depletion is to be computed in the case of mines (other than metal, coal, fluor spar, ball and sagger clay, rock asphalt, or sulphur mines) discovered by the taxpayer after February 28, 1913, is the fair market value of the property at the date of discovery or within 30 days thereafter, if such mines were not acquired as the result of purchase of a proven tract or lease, and if the fair market value of the property is determinable with reasonable accuracy, the taxpayer may compute the depletion allowance (without reference to percentage depletion) in respect of such property for the taxable year by multiplying the adjusted basis of the property by a fraction, the numerator of which is equal to the decline in closed or rock pressure during the taxable year and the denominator of which is equal to the expected total decline in closed or rock pressure on the property remaining as of the taxable year.

For definition of "net income of the taxpayer (computed without allowance for depletion) from the property," see § 29.23 (m)-5 (a).

This section does not apply to metal mines, coal mines, fluor spar mines, ball and sagger clay mines, rock asphalt mines, or sulphur mines or deposits, or to gas wells.

As used in this section the phrase "number of units sold within the taxable year," in the case of a taxpayer reporting income on the cash receipts and disbursements basis, includes the quantities, if any, which payments were received within the taxable year although produced and sold prior to the taxable year, and excludes units sold but not paid for in the taxable year. The phrase does not include units with respect to which depletion deductions were allowed or allowable prior to the taxable year.

Under section 114 (b) (3), in the case of oil and gas wells, a taxpayer may deduct for depletion an amount equal to 29 1/2 percent of the gross income from the property during the taxable year, but such deduction shall not exceed 50 percent of the net income of the taxpayer (computed without allowance for depletion) from the property. (For definitions of "gross income from the property" and "net income of the taxpayer (computed without allowance for depletion) from the property," see § 29.23 (m)-1 (f) and (g).) In no case shall the deduction computed under this section be less than it would be if computed upon the cost or other basis of the property provided in section 113.

§ 29.23 (m)-5 Computation of depletion based on percentage of income in case of coal, metal, and fluorspar mines.

Under section 114 (b) (4) a taxpayer may deduct for depletion an amount equal to 5 percent of the gross income from the property during the taxable year in the case of coal, metal, fluorspar, ball and sagger clay, or rock asphalt mines and an amount equal to 5 percent of the gross income from the property during the taxable year in the case of sulphur mines or deposits, but such deduction shall not in any case exceed 50 percent of the net income of the taxpayer (computed without allowance for depletion) from the property. (For definitions of "gross income from the property" and "net income of the taxpayer (computed without allowance for depletion) from the property," see § 29.23 (m)-1 (f) and (g).) In no case shall the deduction computed under this...
A taxpayer may compute the depletion allowance provided in this section, or in § 29.23 (m)-6, if the property is subject to depletion or depreciation, and in determining whether the property or cost at which any purchase or sale was made represented the actual market value of the property, the stage of the operating life at which the property was sold shall be ascertained as of a certain date, and the relationship or connection existing between the party selling the property and the buyer thereof.

§ 29.23 (m)-7 Determination of fair market value of mineral properties, including oil and gas properties. (a) If the fair market value of the property at the time of a sale was fixed as of a specified date it is to be determined for the purpose of ascertaining the basis for depletion and depreciation deductions, this value must be determined, subject to the exceptions set forth in paragraph (b) of this section, by the Commissioner, by the owner of the property in the light of the conditions and circumstances known at that date, regardless of later discoveries or developments in the property or subsequent improvements in methods of extraction and treatment of the mineral product. The value sought should be that established assuming a transfer between a willing seller and a willing buyer at the date of sale.

(b) To determine the present worth of the future net income which any purchase or sale was made represented the actual market value of the property, the stage of the operating life at which the property was sold shall be ascertained as of a certain date, and the relationship or connection existing between the party selling the property and the buyer thereof.

(c) If the deposit has been sufficiently developed and the ore or mineral has been mined and sold prior to the date of sale, the price received for the product marketed shall be considered as that set forth in paragraph (b) of this section. If the deposit has not been sufficiently developed and the ore or mineral has not been sold prior to the date of sale, the price received for the product marketed shall be considered as that set forth in paragraph (b) of this section. If the deposit has not been sufficiently developed and the ore or mineral has not been sold prior to the date of sale, the price received for the product marketed shall be considered as that set forth in paragraph (b) of this section.

(d) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(e) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(f) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(g) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(h) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(i) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(j) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(k) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(l) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(m) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(n) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(o) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(p) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(q) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(r) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(s) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(t) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(u) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(v) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(w) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(x) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(y) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.

(z) The value of a deposit shall be ascertained by subtracting its capitalized value from the total value of the deposit. The value of the deposit shall be determined by the Commissioner, by the owner of the property, or by an independent appraiser.
value at that date of the mineral property in fees simple.

§ 29.23 (m)–8 Revatuation of mineral deposits not allowed. No revaluation of a property whose value as of any specific date has been determined and approved will be made or allowed during the continuance of the ownership under which the value was so determined and approved, except in the case of a subsequent discovery of nonmetallic minerals, other than fluorspar, ball and sagger clay, rock asphalt, coal, sulphur, oil, or gas, as defined in § 29.23 (m)–14, or of misrepresentation or fraud as to any facts known on the date as of which the valuation was made. Revaluation on account of misrepresentation or fraud or such gross error will be made only with the written approval of the Commissioner. The value should, however, be corrected when a virtual change in ownership of part of the property results as the outcome of litigation. The value should be:

(a) If a revision of the number of remaining recoverable units of mineral in the property has been made in accordance with section 23 (m) and § 29.23 (m)–9, d.

(b) In the case of the sale of a part of the property, between the part sold and the part retained.

§ 29.23 (m)–9 Determination of mineral contents of mines and of oil or gas wells. If it is necessary to estimate or determine with respect to any property as of any specific date the total recoverable units (tons, pounds, ounces, barrels, thousand of cubic feet, or other measure) of mineral products reasonably known, or on good evidence believed, to have existed, in the ground as of that date, the estimate or determination must be made according to the methods current in the industry and in the light of the most accurate and reliable information or data on the selection of a unit of estimate, preference shall be given to the principal units (or units) paid for in the product marketed. The estimate of the recoverable units of the mineral product of the property for the purposes of valuation and depletion shall include as to both quantity and grade:

(a) The ores and minerals "in sight," "blocked out," "developed," or "assured," in the usual or conventional meaning of these terms with respect to the type of the deposit, and

(b) "Probable" or "prospective" ores and minerals (in the corresponding sense), that is, ores and minerals that are believed to exist on the basis of good evidence although not actually known to occur on the basis of existing development; but "probable" or "prospective" ores and minerals may be estimated (1) as to quantity, only in case they are extensions of known deposits or are new bodies or masses whose existence is indicated by geological or other evidence to a high degree of probability, and (2) as to grade, only as accords with the best indications available as to richness.

If the number of recoverable units of mineral in the property has been previ-ously estimated for the prior year or years, and if there has been no known change in the estimate of the prior estimate was based, the number of recoverable units of mineral in the property as of the taxable year will be the number remaining from the prior estimate, but in such case it is ascertained either by the taxpayer or the Commissioner as the result of operations or development work prior to the close of the taxable year that the remaining recoverable units of the taxable year are materially greater or less, the number remaining from the prior estimate, then the estimate of the remaining recoverable units shall be revised and the annual depletion allowance with respect to the property for the taxable year and for subsequent taxable years will be based upon the revised estimate unless a change in the facts requires another revision. Such revised estimate will not, however, affect the basis for depletion.

§ 29.23 (m)–10 Depletion; adjustments of accounts based on bonus or advanced royalty. (a) If a bonus in addition to royalties has been agreed upon for the grant of rights in mineral property, there shall be allowed to the payee a depletion deduction in respect of the bonus an amount equal to that portion of the bonus which is numbered to the depletion deduction in respect of the bonus as of any specific date. Such deduction will not, however, affect the basis for depletion.

(b) If the owner of operating rights in mineral property grants an option to another person to operate the property, the owner of the economic interest in the property is required to pay royalties on the portion of the royalty income of the taxpayer (computed without allowance for depletion) from the property. The owner of an economic interest in fluorspar, ball and sagger clay, or rock asphalt mines may take as a depletion deduction in respect of any bonus or advanced royalty from the property for the taxable year 25½ per cent of the amount thereof, and the owner of an economic interest in sulphur mines, metal mines, and coal mines may take as a depletion deduction in respect of any bonus or advanced royalty from the property for the taxable year 23 percent, 15 percent, and 5 percent, respectively, of the amount thereof; but the deduction shall not in any case exceed 50 percent of the net income of the taxpayer (computed without allowance for depletion) from the property.

(c) If a lessee or other owner of operating rights in one or more mineral properties is required to pay royalties on a specified number of units of mineral annually, whether or not extracted within the year, and may apply any amounts paid on account of units not extracted within the year against the number remaining from the prior estimate, he may at his option treat the advanced royalties so paid or accrued in either one of the following manners:

(1) As deductions from gross income for the years the advanced royalties are paid or accrued, or

(2) As deductions from gross income for the years the mineral product in respect of which the advanced royalties were paid is sold.

The option contained in this paragraph shall apply only to advanced royalties paid or accrued in taxable years ending on or after December 31, 1939, and may apply to such advanced royalties paid or accrued in subsequent years in the same manner.

§ 29.23 (m)–11 Depletion and depreciation accounts on books. Every taxpayer claiming and making a deduction for depletion and depreciation of mineral property shall keep accurate ac-
accounts in which shall be recorded the cost or other basis provided by section 114 (a) to the extent that the case may be, of the mineral deposit and of the plant and equipment, together with subsequent allowable capital additions to each account and all of the other adjustments required by regulations thereunder.

If the plan or method of depletion and depreciation accounting adopted by the taxpayer has once been approved by the Commissioner, it cannot be changed by the taxpayer without the consent of the Commissioner. These accounts shall thereafter be credited annually with the amounts of the depletion and depreciation computed in accordance with §§ 29.23 (m)-2, 29.23 (m)-3, 29.23 (m)-4, or 29.23 (m)-5; or the amounts of the depletion and depreciation so computed 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 cost or other basis of the property, plus subsequent allowable capital additions, no further deductions for depletion and depreciation shall be allowed, except such depletion deductions as may thereafter be allowable under section 114 (b) (2), (3), or (4) and §§ 29.23 (m)-5, 29.23 (m)-4, or 29.23 (m)-3.

Every taxpayer who to whom section 114 (b) (2) and §§ 29.23 (m)-3 are applicable shall keep similar accounts with respect to each mineral property as of a value for any mineral property as of the beginning of the taxable year, the average number of days of production to which the taxpayer is entitled, and the average number of each and every prior year (i) were allowable, (ii) were allowable, and (iii) would have been allowable without reference to percentage depletion or discovery value; and

(10) Any other data which will be helpful in determining the reasonableness of the valuation asserted or of the deduction claimed.

(11) The amount of the depletion for the taxable year and the amount of depletion for the taxable year computed without reference to percentage depletion or discovery value;

(12) The amounts of depletion and depreciation, stated separately, which for each such fraction of the gross production to which the taxpayer is entitled, the name and address and the precise nature of the holding of each person interested in the property, and, in the several cases of a lessor, whether the lease involved was in effect at the close of the taxable year, and, if not, when it was terminated and for what reason, and whether the lessor repurchased the property.

(13) Any other data which is the property shall be attached to return when depletion is claimed in respect of (1) property in which he owns a fractional interest only, or (2) a leasehold, or (3) property subject to lease, there shall also be attached a statement setting forth the fraction of the gross production to which the taxpayer is entitled, the fraction of the gross production to which the property is entitled, and the precision of the holding of each person interested in the property, and, in the case of a lessor, whether the lease involved was in effect at the close of the taxable year, and, if not, when it was terminated for what reason, and whether the lessor repurchased the property.

Any taxpayer who claims depletion of oil and gas properties must furnish a certified copy of the instrument or instruments by which it was acquired;

(14) The date of acquisition and, if under lease, the exact terms and date of expiration of the lease;

(15) The cost of the property, stating the amount paid to each vendor, with his name and address;

(16) The value of the property on that date with a statement of the precise method by which the value was determined;

(17) An allocation of the cost or value between the mineral deposit and other assets such as plant, equipment, or the surface of the land for purposes other than mineral production;

(18) The estimated number of units of each kind of mineral at the end of the taxable year, and also at the date of acquisition, if acquired during the taxable year or at the date of as of which any valuation is made, together with an explanation of the method used in the estimation, the name and address of the person who made the estimate, the basis of the estimate, and the reasons for believing it to be correct;

(19) The number of units sold and the number of units for which payment was received during the year for which the return is made (in the case of newly developed oil and gas properties it is reasonable to assume that the applicable capital additions to each account are necessary to file the production of the property; and

(20) Available geological information having a probable bearing on the oil and gas content; information with respect to geometric characteristics of the reservoir rock, percentage of recovery, expected date of cessation of natural flow, and the estimated potential, and characteristics similar to characteristics of other known fields.

(21) All of the foregoing information must be furnished on oath, should be summarized, and may be included in a single statement which has been previously filed by the taxpayer need not be filed again but the statement attached to the return must indicate clearly when and in what form the information was previously filed. When a taxpayer has filed adequate maps with the Commissioner he may be relieved of filing further maps of the same property if he 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, as well as logs, depth and thickness of sands, location of new wells, etc.

§ 29.23 (m)-13 Statement to be attached to return when depletion is claimed on percentage basis. (a) There shall be attached to the return of every taxpayer who claims depletion of oil and gas wells under section 114 (b) (3) and § 29.23 (m)-4, or depletion of coal mines, metal mines, fluor spar mines, salt mines, sulphur mines or deposits under section 114 (b) (4) and § 29.23 (m)-5, a statement containing the following information with respect to every property for which percentage depletion is allowable:

(1) All data necessary for the determination of the "gross income from the property" as defined in § 29.23 (m)-1 (f), including the amounts paid to lessors and royalties, the interests paid to holders of other interests in the mineral property and the price per unit at which royalties were paid;

(2) All additional data necessary for the determination of the "net income of
The taxpayer (computed without allowance for depletion) "profit from property" as defined in § 29.23 (m)–1 (g) and (3) The information required by paragraphs (a) (1), (a) (2), (a) (3), and (b) of § 29.23 (m)–12. The other information required by § 29.23 (m)–12 shall also be furnished if necessary in determining the gain or loss from the sale or other disposition of the property during the taxable year or if a valuation of the property is necessary for any purpose. The taxpayer may find it desirable to furnish such information in all cases.

(b) All of the foregoing information shall be furnished under oath, should be summarized, and may be included in a single affidavit.

§ 29.23 (m)–14 Discovery of mines, other than coal, metal, fluorspar, ball and sagger clay, rock asphalt, or sulphur mines. (a) To entitle a taxpayer to a valuation of his property, for the purpose of depletion, by reason of the discovery of a mine (other than a coal, metal, fluorspar, ball and sagger clay, rock asphalt, or sulphur mine) or minerals (other than oil or gas, coal, sulphur, metal, fluorspar, ball and sagger clay, rock asphalt), it must appear that the mine or minerals were not acquired as the result of the purchase of a proven tract or lease; also, the discovery be the result of an act by the taxpayer after February 28, 1913, and must result in the fair market value of the property becoming disproportionate to the cost. The fair market value of the property will be deemed to have become disproportionate to the cost when the newly discovered minerals are of such quantity and of such quality as to afford a reasonable expectation of return to the taxpayer of an amount materially in excess of the capital expended in making such discovery plus the cost of future development, equipment, and exploitation.

(b) Expenditures incidental to the discovery of a mineral deposit not excepted by this section may be said to be discovered when (1) there is found a natural deposit of mineral, or (2) there is disclosed by drilling or exploration, conducted for the purpose of discovery, a natural deposit not previously known to exist and the existence of which was so improbable that such deposit had not and could not have been included in any previous valuation for the purpose of depletion, and which in either case exists in quantity and grades sufficient to justify commercial exploitation.

(c) In determining whether a discovery entitling the taxpayer to a valuation of property has been made, the Commissioner will take into account the peculiar conditions of each case; but no discovery, for the purposes of depletion, shall be allowed as to minerals which constitute merely uninterrupted extensions of continuing commercial veins or deposits already known to exist, which have been included in "probable" or "prospective" mineral, or which were in any other way comprehended in a prior valuation, nor can a discovery, for purposes of depletion, be allowed as of a date subsequent to that when, in fact, discovery was evident, when delay by the taxpayer in making claim therefor has resulted or will result in excessive allowances for depletion.

(d) Discoveries include minerals in commercial quantities contained within a vein or deposit discovered in an existing mine or mining tract by the taxpayer or his agents, or any vein or deposit discovered in a mining claim not previously discovered by the taxpayer or his agents must not be merely the uninterrupted extension of a continuing commercial vein or deposit already known to exist, and the newly discovered minerals must be of such quantity and grade as to make it probable that they could be separately mined and marketed at a profit.

(a) The value of property claimed as the result of a discovery must be the fair market value, as defined in § 29.23 (m)–7, based on what is evident within 30 days after the commercially valuable character and extent of the discovered deposits of mineral have with reasonable certainty been established, determined, or proved.

§ 29.23 (m)–15 Allowable capital additions in case of mines. (a) All expenditures in excess of net receipts from minerals sold shall be charged to capital account recoverable through depletion while the mine is in operation. If the mine is located within the territory of a foreign country, the taxpayer in making an election shall be allowed to take into account the probable expenditures required to conduct the mine or operation in such foreign country.

(b) Expenditures for plant and equipment and for replacements, not including expenditures for maintenance and for ordinary and necessary repairs, shall ordinarily be charged to capital account recoverable through depreciation. Expenditures for equipment (including its installation and housing) and for replacements thereof, which are necessary to set up for the drilling of a well to an agreed depth, or depths, at an agreed price per foot or other unit of measurement.

(c) Option with respect to cost of nonproductive wells: In addition to the foregoing option the cost of drilling nonproductive wells at the option of the taxpayer may be deducted from gross income for the year in which the taxpayer completes the drilling of a well or be charged to capital account returnable through depletion and depreciation as in the case of productive wells.

(d) Expenditures not returnable through depletion or depreciation 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 if 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.

(2) Recovery of optional items, if capitalized:

(1) Items returnable through depletion: If in exercising these options, or either of them, the taxpayer charges such expenditures as fall within the options to capital account, the amounts so capitalized in so far as they are not represented by physical property, are returnable through depletion. For the purposes of this section the expenditures for clearing ground, draining, road making, surveying, geological work, excavation, grading, and the drilling, shooting, and cleaning of wells are not considered as having a salvage value, even though used in connection with depletion, or of physical property which has a salvage value. Drilling and development costs shall not be excepted from the option merely because they are incidental for a contract providing for the drilling of a well to an agreed depth, or depths, at an agreed price per foot or other unit of measurement.

(2) Option with respect to cost of nonproductive wells: In additional to the foregoing option the option may be exercised by the taxpayer to cost of drilling nonproductive wells at the option of the taxpayer may be deducted from gross income for the year in which the taxpayer completes the drilling of a well or be charged to capital account returnable through depletion and depreciation as in the case of productive wells.

§ 29.23 (m)–16 Charges to capital and to expense in case of oil and gas wells. (a) Taxable years beginning prior to January 1, 1943. The provisions of this paragraph apply only to taxable years beginning prior to January 1, 1942.

(b) (1) Items chargeable to capital or to expense at taxpayer's option:

(i) Option with respect to intangible drilling and development costs in general: All expenditures for drilling and development are excepted from the option to and necessary for the drilling of wells and the preparation of wells for the production of oil or gas, may, at the option of the taxpayer, be deducted from gross income or be charged to capital account. Such expenditures have for convenience been termed intangible drilling and development costs.
casings and equipment and in the construction of derricks and other physical structures.

(iii) In the case of capitalized intangible drilling and development costs incurred under a contract such costs shall be allocated to the following classes of items for the purposes of determining the depletion and depreciation allowances.

(3) Nonoptional items distinguished:

(i) Capital items: The option with respect to intangible drilling and development costs incurred in general does not apply to expenditures by which the taxpayer acquires tangible property ordinarily considered as having a salvage value. Examples of such items are the costs of the actual materials in those structures which are constructed in the wells and on the property, and the cost of drilling tools, pipe, casing, tubing, tanks, engines, boilers, machines, etc. The options do not apply to any expenditure for wages, fuel, repairs, hauling, supplies, etc., in connection with the operation of the wells and of other facilities on the property for the production of oil or gas. General overhead expense, taxes, and depreciation of drilling equipment, are not considered as capital items, even when incurred during the development of the property.

(ii) Expense items: Expenditures which must be charged off as expense, regardless of the options provided by paragraph (a) of this section, are those for labor, fuel, repairs, hauling, supplies, etc., in connection with the operation of the wells and of other facilities on the property for the production of oil or gas. General overhead expense, taxes, and depreciation of drilling equipment, are not considered as capital items, even when incurred during the development of the property.

(iv) Items returnable through depletion: If the taxpayer charges such expenditures as fall within the option to capital account, the amounts so capitalized and not deducted as a loss are returnable through depletion and are not represented by physical property. For the purposes of this section the expenditures for clearing, grading, surveying, geological work, excavation, grading, and the drilling, shooting, and cleaning of well, are considered not to be represented by physical property.

(v) Option with respect to intangible drilling and development costs incurred by the operator (one who holds a working or operating interest in any tract or parcel of land either as a fee owner or under a lease or any other form of contract granting or operating rights) in the development of oil and gas properties: All expenditures made by an operator for wages, fuel, repairs, hauling, supplies, etc., in connection with the operation of the wells and of other facilities on the property. Such expenditures have been termed intangible drilling and development costs. They include the cost to operators of any drilling or development work which is not chargeable to the extent of the proceeds or gross proceeds from production, and amounts, properly allocable to cost of depreciable property, done for them by contractors and amounts paid for labor, fuel, repairs, hauling, and supplies, or any of them, which are used (a) in the drilling, shooting, and cleaning of wells; (b) in such clearing of ground, draining, road making, surveying, and geological work as are necessary in preparation for the drilling of wells and the construction of such derricks, tanks, pipe lines, and other physical structures as are necessary for the drilling of wells and the preparation of wells for the production of oil or gas. In general, this option applies only to expenditures for those drilling and developing items which are not sold for a salvage value. For the purpose of the option labor, fuel, repairs, and supplies are not considered as having a salvage value, even though used in connection with the installation of physical property which has a salvage value. Included in this option are costs of drilling and development undertaken directly or through a contract by an operator of an oil and gas property whether incurred by him

with the manner in which the respective types of optional items are treated (1) in his return for the first taxable year ending after December 31, 1924, in which optional expenditures of the respective type were made; (2) in any amended return filed before June 18, 1927, and December 18, 1927, in accord-
beginning after December 31, 1942, in which such a nonproductive well is completed. Such election with respect to intangible drilling and development costs of a nonproductive well shall be made, and, when made, shall be binding for all subsequent years. Any taxpayer who incurs optional drilling and development costs in drilling a nonproductive well may, as a statement of election under this option, in the return for the first taxable year beginning after December 31, 1942, in which such nonproductive well is completed. The absence of a declaration in such return of an election to deduct as ordinary losses intangible drilling and development costs of nonproductive wells shall be deemed an election to recover such costs through depletion to the extent that they are not represented by physical property, and through depletion to the extent that they are represented by physical property.

(3) Nonoptional items distinguished:

(a) Capital items: The option with respect to intangible drilling and development costs is not available to the extent that such costs are represented by machines, etc. The option does not apply to expenditures for wages, fuel, repairs, hauling, supplies, etc., in connection with equipment, facilities, or structures, not incident to or necessary for the drilling of wells, such as structures for storing or treating oil or gas. These are capital items and are returnable through depreciation.

(b) Expense items: Expenditures which must be charged off as expense, regardless of the option provided by paragraph (b) of this section, are those for labor, fuel, repairs, hauling, supplies, etc., in connection with the operation of the wells and the equipment and structures used in the mining of deposits, including physical property, such as machinery, tools, equipment, etc., so far as not in conflict with the option exercised by the taxpayer under §29.23 (m)–16. The amount deductible on this account shall be such an amount based upon items or other property depreciated and 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 acquired is limited by its specialized character and reasonable charges for depreciation (see paragraphs (d)–(g) of this section) shall be returned as profit or loss in the year in which it is realized.

(d) The estimated economic life of a plant or unit thereof is the estimated time during which the plant or unit may be continued in use despite physical deterioration, decay, and wear and tear.

(e) Any difference between the salvage value of the equipment and plant and the basis provided in section 113 (a) adjusted as provided by section 113 (b) and proper care and repair, can be continued in use despite physical deterioration, decay, and wear and tear.

(f) Nothing in these regulations shall be interpreted as meaning (1) that the cost or other basis of a mining plant and equipment may be reduced by depreciation deductions to a sum below the value of the property or of that portion of the mineral deposits to which it is related, or (2) that proper deductions for depletion on account of obsolescence and 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 portion of such deductions representing depletion other than mining. Such separation will be required to be made of the reserves for depletion at January 1, 1916, and proper allocation between depletion and depreciation must be maintained after that date.

§ 29.23 (m)–29 Capital recoverable through depletion allowance in case of timber. In general, the capital remaining in any year recoverable through depletion allowances is the basis provided by section 113 (a) adjusted as provided by section 113 (b). For capitalization of carrying charges, see §29.113 (b)–1. The apportionment of deductions between the several owners of economic interests in timber properties may be made as specified in §29.23 (m)–7. The cost of timber properties shall be determined in accordance with the principles indicated in §29.23 (m)–6. For method of determining fair market value and quantity of timber, see §§29.22 (m)–8 to 29.23 (m)–27, inclusive. For depletion purposes the cost of the timber shall not include any part of the cost of the land.
§ 29.23 (m)–21 Computation of allowance for depletion of timber for given year. The allowance for depletion of timber in any taxable year shall be based upon the number of units of timber killed during the year and the depletion unit of the timber in the timber account or accounts pertaining to the timber killed. The depletion unit of the timber for a given timber account in a given year shall be the quotient obtained by dividing, (a) the basis, provided by section 115 (a) and adjusted as provided by section 115 (b), of the timber on hand at the beginning of the year plus the cost of the number of units acquired during the year plus proper additions to capital, by (b) the total number of units of timber on hand in the given account at the beginning of the year plus the number of units acquired during the year plus (or minus) the number of units required to be added (or deducted) by way of correcting the estimate of the number of units remaining available in the account. The amount of the deduction for depletion in any taxable year with respect to a given timber shall be the product of the number of units of timber cut from the account during the year multiplied by the depletion unit of the timber for the given account for the year. These taxpayers who keep their accounts on a monthly basis may, at their option, keep their depletion accounts on a monthly basis, in which case the amount deductible on account of depletion for a given year shall be determined in the manner outlined above for a given year. The total amount of the deduction for depletion in any taxable year shall be the sum of the amounts deductible for the several timber accounts. For description of timber accounts, see §§ 29.23 (m)–27 and 29.23 (m)–28.

The depletion of timber takes place at the time the timber is killed. Since, however, it is generally impracticable to determine the quantity of timber immediately after felling, depletion for purposes of accounting will be treated as taking place at the time when, in the process of exploitation, the quantity of timber killed is first definitely determined.

§ 29.23 (m)–22 Revaluation of timber not allowed. No revaluation of a timber property whose value as of any specific date has been determined and approved will be made or allowed during the continuance of the ownership under which the value was so determined and approved, except in the case of misrepresentation or fraud or gross error as to any fact upon which the value as of such date as of which the valuation was made. Revaluation on account of misrepresentation or fraud or such gross error will be made only with the written approval of the Commissioner. The depletion unit shall be changed when a revision of the remaining number of units of recoverable timber in the property has been made in accordance with § 29.23 (m)–26.

§ 29.23 (m)–23 Depreciation of improvements in case of timber. The cost or other basis of development not represented by physical property having an inventory value shall be recoverable through depreciation. It shall be optional with the taxpayer, subject to the approval of the Commissioner:

(a) Whether the cost or other basis of the property subject to depletion shall be recovered by straight-line method, by the method of units of production, or by the method of exhaustion, or by such other method as may be prescribed by the Commissioner; provided, however, it is not ordinarily practicable to apply the method of exhaustion or the method of units of production to the property in question;

(b) Whether the cost or other basis shall be recovered by appropriate charges for depreciation calculated 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 other basis 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 plantation and equipment 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. It shall be determined, or such factor or factors as may be necessary to determine whether any part of the value of cut-over land may be recoverable through depreciation. See §§ 29.23 (j)–1 to 29.23 (j)–10, inclusive, as to deductions for depreciation and obsolescence generally. See particularly § 29.23 (j)–5 with regard to information which must be furnished in substantiation of deductions claimed for depreciation and obsolescence.

§ 29.23 (m)–24 Information to be furnished by taxpayer claiming depletion of timber. To the income tax return of the taxpayer claiming a deduction for depletion or depreciation or both there shall be attached a map and statement (Form T—Timber) for the taxable year covered by the income tax return. Form T—Timber requires the following:

(a) Map showing timber and land acquired, timber cut, and timber and land sold;

(b) Description of, cost of, and terms of purchase or lease of, timber and land acquired;

(c) Proof of profit or loss from sale of capital assets;

(d) Description of timber with respect to which claim for loss, if any, is made;

(e) Record of timber cut;

(f) Changes in timber account as the result of purchase, sale, cutting, reestimate, or loss;

(g) Changes in physical property accounts as the result of additions to or deductions from capital and depreciation;

(h) Operation data with respect to raw and finished material handled and transportation costs; and

(i) Any other data which will be helpful in determining the reasonableness of the depletion or depreciation deductions claimed in the returns.

Similar information is required for certain years prior to the 1919 taxable year from those taxpayers who have not already furnished it. The specific nature of the information required for the earlier years is given in detail in Form T—General forest industries questionaire for the years prior to 1919.

§ 29.23 (m)–25 Determination of fair market value of timber. If the fair market value of the property at a specified date is the basis for depletion and depreciation deductions, such value shall be determined, subject to approval or revision by the Commissioner, by an audit, by the owner of the property, in the light of the most reliable and accurate information available with reference to the condition of the property as it existed at that date and all subsequent changes, such as changes in surrounding circumstances, in methods of exploitation, in degree of utilization, etc. The value sought shall be the selling price of the property at fair market value to a willing buyer and a willing seller, as of the particular date. Such factors as the following will be given due consideration:

(a) Character and quality of the timber as determined by species, age, size, condition, etc.;

(b) The quantity of timber per acre, the total quantity under consideration, and the location of the timber with reference to other timber;

(c) Accessibility of the timber (location with reference to distance from a common carrier, the topography, and other features of the timber on which the timber stands and over which it must be transported in process of exploitation, the probable cost of exploitation, and the state and the stage of development of the locality); and

(d) The freight rates by common carrier to important markets.

The timber in each particular case will be valued on its merits and not on the basis of general averages for regions; however, the value placed upon it, taking into consideration such factors as those mentioned above, will be consistent with that of the other timber in the region.

The Commissioner will give due weight and consideration to any and all facts and evidence having a bearing on the market value, such as cost, actual sales and transfers of similar properties, the margin between the cost of production and the price realized for timber products, market value of stock or shares, royalties and rentals, value fixed by the owner for the purpose of the capital stock tax, valuation for local or State taxation, partnership accountings, records of litigation in which the value of the property has been involved, the amount at which the property may have been inventoried or appraised in probate or similar proceedings, disinterested appraisals by approved methods, and other factors. For depletions on purposes other than valuation, the market value at a specified date shall not include any part of the value of the land.

If, for the purpose of the equitable apportionment of depletion among the several owners of economic interests, the value of any timber property must be ascertained as of any specific date for the determination of the basis for depletion, the values of the several interests therein may be determined separately, but, when
Determined as of the same date, shall together never exceed the value at that date of the timber property in fee simple.

§ 29.23 Determination of quantity of timber property. Each taxpayer claiming or expecting to claim a deduction for depletion is required to estimate with respect to each separate timber account the total units (pec board measure, log size, or other unit) of timber reasonably known, or on good evidence believed, to have existed on the ground on March 1, 1913, or on the date of acquisition of the property, as the case may be. The taxpayer shall state as nearly as possible the number of units which would have been found present by a careful estimate made on the specified date with the object of determining 100 percent of the quantity of timber which the area would have produced on that date if all of the merchantable timber had been cut and utilized in accordance with the standards of utilization prevailing in that region at that time.

If subsequently the taxpayer may have cut out a section of the timber on the ground or may have utilized a section of the total quantity of timber which would have been found present on the ground by maps or by legal descriptions.

For a period of 2 years after the original determination of depletion or of capital additions, the Commissioner, if convinced of error, may require an estimate to be made on the basis of the above facts and ascertain the difference between the original estimate and the revised estimate, and the part of the difference chargeable to the taxpayer and the part chargeable to the estate of the taxpayer.

§ 29.23 (m)–28 Aggregating timber and land for purposes of valuation and accounting. With a view to logical and reasonable valuation of timber, the taxpayer shall include his timber in one or more accounts.

Each of the several accounts shall be credited with the cost of the total quantity of timber, and the land accounts shall be credited with the cost of the total value of land.

§ 29.23 (m)–28 Timber depletion and depreciation accounts on books. Every taxpayer who claims a deduction for depletion or depreciation of timber property (including plants, improvements, and equipment used in connection therewith) shall keep accurate records and accounts of all timber and land accounts, respectively.

These accounts shall be credited with the amount of the deduction for depletion or depreciation of timber property (including plants, improvements, and equipment used in connection therewith) and with the subsequent allowable capital additions to each account and all of the other adjustments provided by section 29.23 (m)–27, and if no part of their net earnings inures to the benefit of any private shareholder or individual, or to a domestic fraternal society, order, or association, incorporated under foreign law, 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 shareholder or individual, or any trust, or foundation, created or organized under foreign law, shall be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

if any part of such earnings inures to the benefit of any private shareholder or individual, or any trust, or foundation, created or organized under foreign law, shall be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

§ 29.23 (o)–1 Contributions or gifts by individuals. A deduction is allowable under section 29 (d) only with respect to contributions or gifts paid after January 1, 1934, and if no part of their net earnings inures to the benefit of any private shareholder or individual, or any trust, or foundation, created or organized under foreign law, shall be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

[In computing net income there shall be allowed deductions:
(c) Charitable and other contributions. In the case of an individual, contributions or gifts paid within the taxable year to the extent of:
(1) The United States, any State, Territory, or any political subdivision thereof, the District of Columbia, or any possession of the United States, for exclusively public purposes;
(2) A corporation, trust, or community chest, fund, or foundation, created or organized under foreign law, or any State, and no part of the net earnings of which inures to the benefit of any private shareholder or individual, or any trust, or foundation, created or organized under foreign law, or for the prevention of cruelty to children or animals.

(4) A corporation, trust, or community chest, fund, or foundation, created or organized under foreign law, or any State, and no part of the net earnings of which inures to the benefit of any private shareholder or individual, or any trust, or foundation, created or organized under foreign law, or for the prevention of cruelty to children or animals.

If any part of such earnings inures to the benefit of any private shareholder or individual, or any trust, or foundation, created or organized under foreign law, shall be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

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(1) The United States, any State, Territory, or any political subdivision thereof, the District of Columbia, or any possession of the United States, for exclusively public purposes;
(2) A corporation, trust, or community chest, fund, or foundation, created or organized under foreign law, or any State, and no part of the net earnings of which inures to the benefit of any private shareholder or individual, or any trust, or foundation, created or organized under foreign law, or for the prevention of cruelty to children or animals.

(4) A corporation, trust, or community chest, fund, or foundation, created or organized under foreign law, or any State, and no part of the net earnings of which inures to the benefit of any private shareholder or individual, or any trust, or foundation, created or organized under foreign law, or for the prevention of cruelty to children or animals.

If any part of such earnings inures to the benefit of any private shareholder or individual, or any trust, or foundation, created or organized under foreign law, shall be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

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(c) Charitable and other contributions. In the case of an individual, contributions or gifts paid within the taxable year to the extent of:
(1) The United States, any State, Territory, or any political subdivision thereof, the District of Columbia, or any possession of the United States, for exclusively public purposes;
(2) A corporation, trust, or community chest, fund, or foundation, created or organized under foreign law, or any State, and no part of the net earnings of which inures to the benefit of any private shareholder or individual, or any trust, or foundation, created or organized under foreign law, or for the prevention of cruelty to children or animals.

(4) A corporation, trust, or community chest, fund, or foundation, created or organized under foreign law, or any State, and no part of the net earnings of which inures to the benefit of any private shareholder or individual, or any trust, or foundation, created or organized under foreign law, or for the prevention of cruelty to children or animals.

If any part of such earnings inures to the benefit of any private shareholder or individual, or any trust, or foundation, created or organized under foreign law, shall be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

[In computing net income there shall be allowed deductions:
(c) Charitable and other contributions. In the case of an individual, contributions or gifts paid within the taxable year to the extent of:
(1) The United States, any State, Territory, or any political subdivision thereof, the District of Columbia, or any possession of the United States, for exclusively public purposes;
(2) A corporation, trust, or community chest, fund, or foundation, created or organized under foreign law, or any State, and no part of the net earnings of which inures to the benefit of any private shareholder or individual, or any trust, or foundation, created or organized under foreign law, or for the prevention of cruelty to children or animals.

(4) A corporation, trust, or community chest, fund, or foundation, created or organized under foreign law, or any State, and no part of the net earnings of which inures to the benefit of any private shareholder or individual, or any trust, or foundation, created or organized under foreign law, or for the prevention of cruelty to children or animals.

If any part of such earnings inures to the benefit of any private shareholder or individual, or any trust, or foundation, created or organized under foreign law, shall be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

§ 29.23 (m)–27 Aggregating timber and land for purposes of valuation and accounting. With a view to logical and reasonable valuation of timber, the taxpayer shall include his timber in one or more accounts.

In general, each such account shall include all of the taxpayer's timber which is located in one "block," a block being an operation unit which includes all of the taxpayer's timber which would logically go to a single given point of manufacture. In those cases in which the point of manufacture is at a considerable distance, or in which the logs or other products will probably be sold in a log or other market, the block may be a logging unit which includes all of the taxpayer's timber which would logically be removed by a single logging development.

In exceptional cases, provided that there are good and substantial reasons, and subject to approval or re-vision by the Commissioner on audit, the taxpayer may divide the timber in a given block into two or more accounts, e.g., timber of different species or groups of tree species may be carried in distinct accounts, or special timber products may be carried in distinct accounts, or blocks may be divided into two or more accounts based on the character of the timber or its accessibility, or so as to be included in separate accounts. If such a division is made, a proper portion of the total value or cost, as the case may be, shall be allocated to each account.

The second paragraph of this section shall not include any part of the value or cost, as the case may be, of the stock.
litical subdivision thereof, or the District of Columbia, or any possession of the United States, exclusively for public purposes, is deductible.

No deduction is allowed in computing the net income of a common trust fund or a partnership during its taxable year to such organizations may be allowed as a deduction in his individual return for his taxable year with or within which the taxable year of the partnership ends, to an amount which, when added to the amount of contributions made by the partner individually and claimed as a deduction, is not in excess of 15 percent of his net income computed without the benefit of the deduction for contributions. In the case of a nonresident alien individual or a citizen of the United States entitled to the benefits of section 261, see secs. 261 (a) and 261. For contributions or gifts by corporations, see § 29.22 (e)-1.

In the case of a husband and wife making a joint return, the deduction for contributions or gifts is the aggregate of such contributions or gifts made by the spouses, and is limited to 15 percent of the aggregate net income of the spouses (computed without regard to such contributions or gifts) as shown by the joint return.

A donation made by an individual to an organization other than one referred to in section 23 (a) which bears a direct relationship to his business and is made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute an allowable deduction as business expense.

Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertisements, and contributions for campaign expenses, are not deductible from gross income.

If the contribution or gift is other than money, the basis for calculation of the amount thereof shall be the fair market value of the property at the time of the contribution or gift.

In connection with claims for deductions under section 23 (c), there shall be stated in returns of income the name and address of the organization to which a contribution or gift was made and the amount and the approximate date of the actual payment of the contribution or gift in each case. Claims for deductions under section 23 (b) must be substantiated, when required by the Commissioner, by a statement from the organization to which the contribution or gift was made showing whether the organization is a domestic organization or an organization which is exempt under section 102 (a), (23) (c), (31), or (56) (b), (218) (b), and if refunds of premiums, if any, are not applied within the current taxable year or the next succeeding taxable year towards the purchase of such retirement annuities.

In the case of a husband and wife making a joint return, the contributions or gifts are paid into a stock bonus or profit-sharing trust, and if such taxable year ends within or with a taxable year of the trust, the amount of such contributions paid into such trust for the purposes of applying the term "stock bonus or profit-sharing trust," as used in this subparagraph, shall not exceed 15 percent of the compensation otherwise paid or accrued during such taxable year to the beneficiaries under such trusts.

The term "stock bonus or profit-sharing trust," as used in this subparagraph, shall not include any trust designed to provide benefits, if any, to employees other than employees under such trusts and plans, of the aggregate net income of the trust for the purposes of applying the term "stock bonus or profit-sharing trust," as used in this subparagraph, shall not exceed 15 percent of the compensation otherwise paid or accrued during such taxable year to the beneficiaries under such trusts.

For the purpose of applying the limitation on deductibility of contributions for stock bonus or profit-sharing trusts, any stock bonus or profit-sharing trust shall be considered as a single trust for the purposes of applying the limitations in this subparagraph.

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penion otherwise paid or accrued during such taxable years to the beneficiaries under the trusts and annuity plans. Contributions made by the employer which do not have the effect of reducing the amount otherwise deductible under subparagraphs (A), (B), and (C), if no employee is a beneficiary under more than one trust, or a trust and an annuity plan. If there is no plan but a method of employer contributions or compensation has the effect of a stock bonus, profit-sharing, or annuity plan, or similar plan deferring the receipt of compensation, this paragraph shall apply with respect to such a plan.

(2) Deductions under prior income tax acts. Any deduction allowable under section 23 (q) of the Revenue Act of 1928 (45 Stat. 902), or the Revenue Act of 1932 (48 Stat. 691), under section 23 (p) of the Revenue Act of 1935 (49 Stat. 1661), or the Revenue Act of 1936 (49 Stat. 661), or the Internal Revenue Code for a taxable year beginning before January 1, 1943, which under such section was apportioned to any taxable year beginning after December 31, 1942, shall be allowed as a deduction for the years to which such apportionment was allowable under such section if it had remained in force with respect to such year.

[Note: Prior to its amendment by section 162 (b) of the Act of 1943, section 23 (p) read, as follows:
(p) Pension trust—(1) General rule. An employer shall not be entitled to an allowable deduction or maintaining a pension trust to provide for the payment of reasonable pensions to his employees shall be allowed as a deduction (in addition to the contributions made by the employer) during any taxable year to cover the pension liability securing during the year, allowed as a deduction under this section (a) of this section a reasonable amount transferred or paid into such trust during the taxable year in excess of such contributions. Only that amount (1) has not theretofore been allowable as a deduction, and (2) is apportioned in equal parts over a period of ten consecutive years beginning with the year in which the transfer or payment is made.
(2) Deductions under prior income tax acts. Any deduction allowable under section 23 (q) of the Revenue Act of 1928 (45 Stat. 902), or the Revenue Act of 1932 (48 Stat. 691), or the Revenue Act of 1935 (49 Stat. 1661), or the Revenue Act of 1936 (49 Stat. 661), or the Revenue Act of 1937 (50 Stat. 644), or the Internal Revenue Code for a taxable year beginning before January 1, 1943, which under such section was apportioned to any taxable year beginning after December 31, 1942, shall be allowed as a deduction for the years to which such apportionment was allowable under such section if it had remained in force with respect to such year.

§ 29.23 (p)-1 Contributions of an employer to an employees' trust or annuity plan and compensation under a deferred payment plan; in general. Section 23 (p) prescribes limitations upon deductibility of contributions of an employer under a stock bonus, pension, profit-sharing, or annuity plan, or deferred compensation plan, but it includes any method of contributions or compensation having the effect of a stock bonus, pension, profit-sharing, or annuity plan, or similar plan deferring the receipt of compensation. Thus, a corporation paying pensions to such of its retired employees and in such amount as may be deemed from time to time by the board of directors or responsible officers of the company has a plan in effect that is governed by section 23 (p). If an employer on the accrual basis defers payment of compensation after the year of accrual merely because of inability to pay such compensation in the year of accrual, as, for example, where the funds of the company are not sufficient to enable payment of the compensation without jeopardizing the solvency of the company, or where the liability accrues in the earlier year, but the amount cannot be exactly determined until the later year.

Deductions under section 23 (p) are generally allowable only for the year for which the compensation is paid, regardless of the fact that the taxpayer may make his return on the accrual basis. Exceptions are made in the case of overpayments as provided in subparagraphs (A), (C), and (F) of section 23 (p) (1), and subparagraphs (A), (C), and (F) of section 23 (p) (1) (E), in the case of payments made by a taxpayer on the accrual basis within 60 days after the close of the company's taxable year. This latter provision is intended to permit a taxpayer on the accrual basis to

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deduct such accrued contribution or compensation, provided payment is actually made within 60 days after the close of the year of accrual.

Any payments shall be disallowed as a deduction under section 23 (p), if determined by the National War Labor Board, the Secretary of Agriculture, or the Commissioner to have been made in contravention of the Act of October 2, 1942, entitled "An Act to amend the Emergency Price Control Act of 1942, to aid in preventing inflation, and for other purposes," as amended (Public Law 729, Seventy-seventh Congress; Public Law 24, Seventy-eighth Congress), or of the regulations, orders, or rulings promulgated thereunder.

§ 23.23 (p)−2 Information to be furnished by employer claiming deductions.

If a deduction from gross income is claimed under section 23 (p) (1) (A), (B), (C), or (F) the employer must file the following information to establish that the plan or plans meet the requirements of sections 165 (a) or 23 (p) (1) (B), and that the contributions claimed do not exceed the amount allowable under subparagraphs (A), (B), (C), or (F) of section 23 (p) (1), as the case may be: (a) Verified copies of all the instruments constituting the plan or plans intended to qualify under section 165 (a), including trust indentures, group annuity contracts, and specimen copy of each type of individual contract, with all amendments to any such instruments; (b) A statement describing the plan or plans which indicates the name or names of the employers, date of inception of each plan, type of administration (whether a trust or an insured plan), and a summary of the provisions relating to: (1) Employee eligibility requirements for participation in the plan, (2) Exemptions, if any, (3) Employer contributions, (4) The basis or formula for determining the amount of each type of benefit and the requirements for obtaining such benefits, (5) The vesting requirements, (6) The method of funding, and (7) The basis of distribution upon liquidation.

(c) A tabulation in columnar form showing the information specified below with respect to each of the 25 highest paid employees, listed in the order of their compensation, covered by the plan: (1) Name, (2) Whether an officer, (3) Percentage of each class of stock owned directly or indirectly by the employee or members of his family, (4) Whether the principal duties consist in supervising the work of other employees, (5) Year of birth, (6) Length of service for employer on date of statement, (7) The compensation paid or accrued during the taxable year showing separately (i) basic salary, (ii) other direct payments, such as bonuses and commissions, (iii) compensation paid other than in cash, such as goods, services, insurance protection, etc.

(8) Amounts contributed during the taxable year with respect to the employee by the employer under each other plan of deferred compensation.

(9) Amounts contributed during the taxable year by the employer for the benefit of the employee for (i) retirement annuity or other deferred benefits, showing amounts paid for (a) past service and (b) current service, (ii) life insurance protection, if any, (iii) percentage which each such contribution bears to total of such contributions made for all employees under the plan.

(10) The method and assumptions used in determining the total employer contributions, the amount of employer liability under the plan (i) with respect to service rendered by the employee prior to the taxable year and (ii) with respect to current service of the employee for the taxable year.

(11) If a pension plan, the amount of benefit to be normally payable annually to a retiring employee.

(d) The total for items (7) and (8) set forth in paragraph (c) of this section with respect to all of the employees included with respect to all of the employees included with respect to all of the employees included under the plan.

(e) A schedule showing the total number of employees as of the close of the taxable year for each of the following groups:

(1) All seasonal and part-time employees excluded under the percentage calculations specified in paragraphs (A), (B), or (C) (reasonably estimated).

(2) All employees excluded under the years of service requirement (reasonably estimated).

(3) All employees excluded because older than a maximum age (reasonably estimated).

(4) All employees excluded because younger than a minimum age (reasonably estimated).

(5) All employees excluded because of maximum salary requirement.

(6) All employees excluded solely because of minimum salary requirement and by separate schedule all employees excluded both because of minimum salary requirement and other reason or reasons.

(7) All employees excluded for reasons other than those listed above, specifying reasons.

(8) All employees covered by the plan.

(9) All employees of the employer.

(10) A detailed balance sheet together with or including actuarially determined assets and liabilities, showing equities under insurance or annuity contracts, if any; and a statement of receipts and disbursements during the year.

(g) A statement or schedules showing the valuation assumptions with respect to interest; mortality, turnover, rate of salary increase, etc., used in determining the cost under the plan. In addition, a statement showing the method of application of such factors to the data, in sufficient detail to permit actuarial analysis as to adequacy thereof and a summary of the costs claimed, by risk or other pertinent groups, showing the basis for determining the amount of deduction claimed.

If a deduction is claimed under section 23 (p) (1) (D) for the taxable year, the following information as is necessary to show that the deduction is not allowable under the other subparagraphs of section 23 (p) (1), that the amount paid is an ordinary and necessary expense, and that the employees' rights or derived from an employer's contribution or such compensation were nonforfeitable at the time the contribution or compensation was paid.

The Commissioner may, in addition, require any further information that he considers necessary to establish deductions under section 23 (p), and may waive the filing of such portion thereof in any particular case, if the data and information required to be filed under paragraphs (a), (b), and (g) of this section are filed for the fiscal year in which the contributions described in paragraph (g) of this section, in which case a statement shall be filed at the close of the taxable year showing that contributions have been made and the effect thereof. The information required under the other paragraphs of this section shall be filed annually, unless the Commissioner waives the filing of any portion thereof in any particular case.

Records substantiating all data and information specified in this section must be kept at all times available for inspection by internal revenue officers at the main office or place of business of the employer.

§ 23.23 (p)−3 Amounts deductible under a plan in effect on or before September 1, 1942 for a taxable year beginning in 1942.

For the purposes of Section 165 (a) (1) of the Internal Revenue Code, as amended by the Revenue Act of 1942, as amended by section 165 (a) (3) of the Internal Revenue Code, as amended by the Revenue Act of 1942, for such taxable year, the amount paid in such taxable year prior to September 1, 1942, to the extent that such amount is deductible under section 23 (a) and section 23 (p), prior to its amendment by the Revenue Act of 1942, plus such portion of the amount paid on or after September 1, 1942, and deductible under section 23 (p) (1), as amended by the Revenue Act of 1942, which the number of months after August 31, 1942, in the taxable year bears to 12. For such amounts paid in such taxable year prior to September 1, 1942, the amount deductible under section 23 (a) and section 23 (p), prior to its amendment by the Revenue Act of 1942, plus such portion of the amount paid on or after September 1, 1942, and deductible under section 23 (p) (1), as amended by the Revenue Act of 1942, which the number of months after August 31, 1942, by which the number of months in the taxable year bears to 12, and for such amounts paid in such taxable year after September 1, 1942, and for which deductions are claimed under section 23 (p), such data and information need not be filed for subsequent years unless a change is made in the plan, instruments, or contributions described in paragraph (g) of this section, in which case a statement shall be filed at the close of the taxable year showing that changes have been made and the effect thereof. The information required under the other paragraphs of this section shall be filed annually, unless the Commissioner waives the filing of any portion thereof in any particular case.
1. In addition to the requirement that a contribution to be deductible must be an ordinary and necessary expense, the amount of a contribution to a pension trust deductible for any taxable year is subject to the further limitations set out in section 23 (p) (1) (A).

In determining allowable deductions all calculations must consider discount for expected increases in the employee's anticipatory interest and may consider expected turnover, anticipated salary increases, variable retirement ages, variations in mortality for different classes of risks, other pertinent facts of a business nature, and expenses of operation. In any event, the amount of deduction otherwise allowable for the taxable year shall be reduced by any decrease in liability which may arise from an experience during the next preceding taxable year more favorable than the assumed experience on which the cost calculations were based for each year. In no event shall an increased rate of cost be allowed after any mortality table require premiums greater than, reasonable amounts warranted under the circumstances. In the case of contributions made to a trust where the employer inures a profit to an employee, or the amount deductible under section 23 (p) (1) (C) of the Revenue Act of 1942. A deduction of $200,000 will be allowable for 1942, determined as follows:

Amount contributed prior to September 1, 1942, and deductible under section 23 (p) and section 23 (p), prior to its amendment by the Revenue Act of 1942, but that only $240,000 thereof is deductible under section 23 (p), as amended, by the Revenue Act of 1942, without any deduction under section 23 (p) (1) (C) of the Revenue Act of 1942. A deduction of $280,000 will be allowable for 1942, determined as follows:

Amount contributed prior to September 1, 1942, and deductible under section 23 (p), prior to its amendment, $200,000 Pro-rata portion of total 1942 contributions allowable under section 23 (p), as amended (1/2 of $240,000) $80,000

\[ \text{Total} = 280,000 \]

\[ \text{Section 29.23 (p)-4 Contribution of an employer to an employees' pension trust, in general (section 23 (p) (1) (A)).} \]

A contribution of an employer to a pension trust to be deductible under section 23 (p) (1) (A) is paid into the retirement fund of the employer which ends within or with a taxable year of the trust for which the trust is exempt under section 163 (a). The term "pension trust" as used in section 23 (p) (1) (A) means a trust created or owned by an employer to provide definite actuarially determinable benefits for his employees, which may include former employees, or their beneficiaries, to be paid over a period of years, generally for life, after the retirement of employees, based on service prior to retirement. The retirement benefits may be forfeitable or non-forfeitable. Retirement benefits are basically only life annuities payable after retirement. However, for purposes of this section a retirement benefit may include the following additional benefits:

(a) a death benefit, as provided in the trust agreement, so long as the results of the actuarial valuation are reasonable and do not cause any discrimination.

(b) a benefit upon death or separation from service or upon termination of participation in the plan of an amount as provided in the plan but not to exceed the reserve accumulated for the retirement annuity at the time.

(c) any additional benefits, such as life insurance payments or annuity payments which may be paid over a period of years, (b) a benefit upon death or separation from service or upon termination of participation in the plan of an amount as provided in the plan but not to exceed the reserve accumulated for the retirement annuity at the time.

Any additional benefits, such as life insurance payments or annuity payments which may be paid over a period of years, may include the income of the employee as additional compensation in the year or years payments for such life insurance are made. See 29.165-6. An amount to be deductible under section 23 (p) (1) (A) must also meet the requirements of section 23 (a). It must be an ordinary and necessary expense. See 29.23 (p)-

the remaining unfunded cost of past and current service credits of all employees under the plan.

For the second year and each fifth year thereafter the taxpayer shall submit with his return a certification by a qualified actuary or the company underwriting the pension of the amount determined to be necessary to provide the remaining unfunded cost of past and current service credits. Such certificate shall be accompanied by appropriate supporting data. If the Commissioner determines that the deduction claimed for the taxable year exceeds the percentage limitation for future years shall be reduced to such amount as may be determined by the Commissioner. During each future year the amount deductible shall be limited to such lower percentage as has been approved by the Commissioner, and no change will be permitted in such percentage until a subsequent actuarial valuation shows such change to be necessary. Such subsequent valuation may be made at any time by the taxpayer and submitted to the Commissioner.
“Normal cost” for any taxable year is the cost actuarially determined which would be required during such year to maintain the plan assuming that the refund is made or during his next succeeding taxable year, toward the purchase of such retirement annuities for the employee covered by the plan. This provision applies whether the refund is made upon the termination of any annuity contract or prior thereto. If the annuity plan is qualified under section 23 (p) (1) (C), all amounts refunded under an annuity contract shall be applied during the taxable year of the employer in which the refund is made or during the next succeeding taxable year if such amounts are contributed by an employer to a pension trust and not to a stock bonus or profit-sharing trust, as to the amounts of contributions deductible under section 23 (p) (1) (A), see §§ 29.23 (p)–4 to 29.23 (p)–7, inclusive.

The amount of contributions deductible under section 23 (p) (1) (C) in any taxable year is limited to the compensation otherwise paid or accrued during the taxable year to all of the employees covered by the stock bonus or profit-sharing plan. The term “compensation otherwise paid or accrued” means all of the compensation paid or accrued except that for which a deduction is allowable under a plan that complies with the requirements of section 23 (p) (1) (A). If contributions are made by an employer during a taxable year to two or more stock bonus or profit-sharing trusts, he is limited in his deduction to 15 percent of the compensation otherwise paid or accrued during the taxable year to all of the employees covered by such trusts.

If an employer contributes in any taxable year beginning after December 31, 1941, an amount in excess of the maximum amount for which he is allowed a deduction under section 23 (p) (1) (C), such excess shall be deductible in the succeeding taxable years in order of time, but the total amount deductible in any one taxable year shall not exceed 15 percent of the compensation otherwise paid or accrued during such succeeding taxable year to the employees covered by the plan in such year. For example, if an employer pays into a profit-sharing trust during 1943 $100,000, and he is limited to a deduction of $60,000 for such year under the 15 percent limitation provision, he may carry forward the remaining $40,000 although entitled to a deduction of $100,000 for 1944, if he had paid in that amount, nevertheless he will be allowed a deduction of $100,000 for 1944. The remaining $10,000 of the compensation not deductible for 1943 or 1944 shall be allowable as a deduction in any succeeding taxable year or years in order of time to the extent that he has not made a contribution of the maximum allowable for such succeeding year or years.

If such contributions are made in any taxable year beginning after December 31, 1941, and such contributions are less than the maximum amount that would have been deductible for such year if contributed, the excess of such maximum amount over the amount actually contributed, or if no amount was contributed, then such maximum amount shall be carried forward and be deductible for the succeeding taxable years, in order of time, but the amount so carried forward shall not be deductible for any taxable year in an amount in excess of 15 percent of the compensation otherwise paid or accrued during such taxable year to the employees covered by the plan. For example, an employer paid into an exempt

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165 (a) · (3), (4), (5), and (6). See §§ 29.165–3 to 29.165–5, inclusive. In the case of an annuity plan in effect on or before the beginning of 1943, the annuity plan need not meet the requirements of section 165 (a) (3), (4), (5), and (6) except for taxable years beginning after December 31, 1942. See section 165 (d) of the Revenue Act of 1942, as late in time as immediately preceding § 29.23 (p)–1. In addition, no deduction will be allowable for any taxable year under section 23 (p) (1) (B) if any refund of premiums which may be credited under an annuity contract is not applied within the taxable year in which it is received or within the next succeeding taxable year, toward the purchase of such retirement annuities for the employee covered by the annuity plan. This provision applies whether the refund is made upon the termination of any annuity contract or prior thereto. If the annuity plan is qualified under section 23 (p) (1) (C), all amounts refunded under an annuity contract shall be applied during the taxable year of the employer in which the refund is made or during the next succeeding taxable year if such amounts are contributed by an employer to a pension trust and not to a stock bonus or profit-sharing trust, as to the amounts of contributions deductible under section 23 (p) (1) (A), see §§ 29.23 (p)–4 to 29.23 (p)–7, inclusive.

The amount of contributions deductible under section 23 (p) (1) (C) in any taxable year is limited to the compensation otherwise paid or accrued during the taxable year to all of the employees covered by the stock bonus or profit-sharing plan. The term “compensation otherwise paid or accrued” means all of the compensation paid or accrued except that for which a deduction is allowable under a plan that complies with the requirements of section 23 (p) (1) (A). If contributions are made by an employer during a taxable year to two or more stock bonus or profit-sharing trusts, he is limited in his deduction to 15 percent of the compensation otherwise paid or accrued during the taxable year to all of the employees covered by such trusts.

If an employer contributes in any taxable year beginning after December 31, 1941, an amount in excess of the maximum amount for which he is allowed a deduction under section 23 (p) (1) (C), such excess shall be deductible in the succeeding taxable years in order of time, but the total amount deductible in any one taxable year shall not exceed 15 percent of the compensation otherwise paid or accrued during such succeeding taxable year to the employees covered by the plan in such year. For example, if an employer pays into a profit-sharing trust during 1943 $100,000, and he is limited to a deduction of $60,000 for such year under the 15 percent limitation provision, he may carry forward the remaining $40,000 although entitled to a deduction of $100,000 for 1944, if he had paid in that amount, nevertheless he will be allowed a deduction of $100,000 for 1944. The remaining $10,000 of the compensation not deductible for 1943 or 1944 shall be allowable as a deduction in any succeeding taxable year or years in order of time to the extent that he has not made a contribution of the maximum allowable for such succeeding year or years.

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29.23 (p)–9 Contributions of an employer to an employees' pension trust; deduction of amounts paid in a taxable year (section 23 (p) (1) (iv)). Any amount paid in a taxable year in excess of the amount deductible in such a taxable year as to the amounts of contributions deductible under section 23 (p) (1) (A) shall be deductible under the provisions of clause (iv) in the succeeding taxable years in order of time to the extent of the difference between the amounts paid and deductible in each such succeeding taxable year and the maximum amounts deductible for such year in accordance with the limitations under clause (ii) or (iii), whichever is applicable. The term “maximum amount of the plan required the taxpayer to pay under the plan $100,000 for the taxable year 1942, and he paid $150,000, he would be allowed a deduction of $100,000 for 1942, but the maximum amount deductible under section 23 (p) (1) (A) for 1943 would be $100,000 for 1943, and he paid in $75,000 that year, he would be allowed a deduction of $100,000 for 1943, and he would be allowed to take the remaining $25,000 in 1944, or for the first succeeding year or years, in which he pays in less than the normal cost for that year.

29.23 (p)–10 Contributions of an employer to a stock bonus or profit sharing trust (sections 23 (p) (1) (C)). Section 23 (p) (1) (C) applies to contributions of an employer to a stock bonus or profit-sharing trust that meets the requirements of section 165 (a). The contributions to be deductible under this section must be paid in a taxable year of the employer which ends within or with a taxable year of the trust with respect to which the trust is exempt under section 165 (a). Any amount deductible under any of the subdivisions of section 23 (p) (1) (A), (B), or (C) shall be deductible under section 23 (p) (1) (C), since such amounts represent contributions to a pension trust and not to a stock bonus or profit-sharing trust. As to the types of contributions deductible under section 23 (p) (1) (A), see §§ 29.23 (p)–4 to 29.23 (p)–7, inclusive.

The amount of contributions deductible under section 23 (p) (1) (C) in any taxable year is limited to the compensation otherwise paid or accrued during the taxable year to all of the employees covered by the stock bonus or profit-sharing plan. The term “compensation otherwise paid or accrued” means all of the compensation paid or accrued except that for which a deduction is allowable under a plan that complies with the requirements of section 23 (p) (1) (A). If contributions are made by an employer during a taxable year to two or more stock bonus or profit-sharing trusts, he is limited in his deduction to 15 percent of the compensation otherwise paid or accrued during the taxable year to all of the employees covered by such trusts.

If an employer contributes in any taxable year beginning after December 31, 1941, an amount in excess of the maximum amount for which he is allowed a deduction under section 23 (p) (1) (C), such excess shall be deductible in the succeeding taxable years in order of time, but the total amount deductible in any one taxable year shall not exceed 15 percent of the compensation otherwise paid or accrued during such succeeding taxable year to the employees covered by the plan in such year. For example, if an employer pays into a profit-sharing trust during 1943 $100,000, and he is limited to a deduction of $60,000 for such year under the 15 percent limitation provision, he may carry forward the remaining $40,000 although entitled to a deduction of $100,000 for 1944, if he had paid in that amount, nevertheless he will be allowed a deduction of $100,000 for 1944. The remaining $10,000 of the compensation not deductible for 1943 or 1944 shall be allowable as a deduction in any succeeding taxable year or years in order of time to the extent that he has not made a contribution of the maximum allowable for such succeeding year or years.

If such contributions are made in any taxable year beginning after December 31, 1941, and such contributions are less than the maximum amount that would have been deductible for such year if contributed, the excess of such maximum amount over the amount actually contributed, or if no amount was contributed, then such maximum amount shall be carried forward and be deductible for the succeeding taxable years, in order of time, but the amount so carried forward shall not be deductible for any taxable year in an amount in excess of 15 percent of the compensation otherwise paid or accrued during such taxable year to the employees covered by the plan. For example, an employer paid into an exempt

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profilt-sharing trust in 1942 $50,000. Fifteen percent of the total compensation paid or accrued to the employees covered by the trust, not including the amounts contributed to the trust on behalf of such employees, for such year amounted to $62,000. This amount includes 60 percent of such compensation for such employees amounting to $125,000. The employer contributed $200,000 to such a trust during that year. The amount deductible under section 23 (p) (1) (C) to $225,000; $125,000 (amount equal to 15 percent of the compensation otherwise paid in 1943) plus $100,000 (amount carried forward from 1942, which is not in excess of such 15 percent of such compensation).

§ 29.23 (p)-11 Contributions of an employer under a plan that does not meet the requirements of section 165 (a) (section 23 (p) (1) (D)). Subparagraph (D) of section 23 (p) (1) covers all cases for which deductions are allowable under section 23 (p) (1) but not allowable under subparagraphs (A), (B), or (C) of such section. No deduction is allowable under section 23 (p) (1) (D) for any contribution paid or accrued by an employer under a stock bonus, pension, profit-sharing, or annuity plan, or for any compensation paid or accrued on account of any employee covered by a plan deferring the receipt of such compensation, except for the year when paid, and then only to the extent allowable under section 23 (p) (1). See § 29.23 (p)-1. If payment of such compensation is not made and the amounts are not deductible under the other subparagraphs of section 23 (p) (1), they are deductible under subparagraph (D) to the extent that individual employees' rights to or derived from such employer's contributions from such employer's contribution or gift were nonforfeitable at the time the contribution or compensation was paid. As to what constitutes nonforfeitable rights of an employee, see § 29.165-7. If an amount is accrued but not paid during the taxable year, or if paid during the taxable year and the employees' rights are forfeitable at the time they are paid, no deduction will be allowed the employer for such amount for such taxable year.

§ 29.23 (p)-12 Contributions of an employer to two or more employees' trusts, or annuity plans (section 23 (p) (1) (F)). Section 23 (p) (1) (F) covers cases where an employer makes contributions either to (a) a pension trust and a profit-sharing or stock bonus trust, or (b) a profit-sharing or stock bonus trust and an annuity plan, or (c) two pension and profit-sharing or stock bonus trusts and an annuity plan, and such contributions are made under a plan or plans that meet the requirements of section 165 (a). It does not cover cases where an employer makes contributions to two or more pension trusts or to a pension trust and under an annuity plan or plans. In such cases the deduction is limited under section 23 (p) (1) (A) if made under a plan that meets the requirements of section 165 (a) or, if not meeting such requirements, then under section 23 (p) (1) (D). Neither is it applicable to a case where there are only two or more stock bonus or profit-sharing trusts. See § 29.23 (p)-10. If no deduction is allowable under more than one trust, or a trust and an annuity plan, section 23 (p) (1) (F) is not applicable.

The amount deductible under section 23 (p) (1) (F) is limited to 25 percent of the compensation otherwise paid or accrued during the taxable year to the employees covered by the plans. The term "compensation otherwise paid or accrued" means all of the compensation otherwise paid or accrued except that for which a deduction is allowable under a plan that qualifies under section 165 (a). If an employer contributes on an amount under such plans in excess of the 25 percent limitation, he shall be allowed deductions for such excess in the succeeding years in order of time but limited in amount to the total amount allowable under section 23 (p) (1) (F) for any one taxable year shall not exceed 30 percent of the compensation otherwise paid or accrued during such taxable year to the employees covered by the plans. For example, if an employer on the calendar year basis contributed during 1942 to pension and profit-sharing trusts amounts equal to 40 percent of the compensation otherwise paid employees covered by the plans, and in 1943 contributed to such trusts an amount equal to 25 percent of such compensation, a deduction should be allowed for 1943 for excesses for which no deduction was allowable for 1942 plus the amount otherwise allowable for 1943 in an aggregate amount not in excess of 30 percent of the compensation otherwise paid such employees for 1943. If there remained a portion of such excess for which no deduction was allowable for 1943, such portion could be carried over to 1944 and successive taxable years, subject to the 30 percent limitation.

[Sec. 23. Deductions from gross income—as amended by secs. 211 (a), 224, Rev. Act 1939; secs. 211, 165 (a), 1940; sect. 10 (b), Excess Profits Tax Amendments 1941; sec. 203 (a), Rev. Act 1941; sect. 105 (c), 120 (b), deduction (c), 122 (a), 124 (a), 125, 126 (a), 127 (c), 129 (a), 129 (b), 130 (b), Rev. Act 1942.)

In computing net income there shall be allowed as deductions:

(a) Charitable and other contributions by corporations. In the case of a corporation, contributions or gifts payment of which is made within the taxable year to or for the use of—

(1) The United States, any State, Territory, or any political subdivision thereof or the District of Columbia, or any possession of the United States, for exclusively public purposes;

(2) A corporation, trust, or community chest, fund, or foundation, created or organized in the United States or in any possession thereof or under the laws of the United States, or of any State or Territory, or of the District of Columbia, or of any possession of the United States, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children (fund) and in the case of contributions or gifts to a trust, chest, fund, or foundation, payment of which is made within the taxable year beginning after the date of the cessation of hostilities in the present war, as proclaimed by the President, only if such contributions or gifts are to be used within the United States or any of its possessions exclusively for such purposes, (b) no part of the net earnings of which shall inure to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on or promoting propaganda, or otherwise attempting, to influence legislation to an amount which does not exceed 5 percent of the taxpayer's net income as computed without the benefits of this subsection. Such contributions or gifts shall be deductible only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary.

§ 29.23 (q)-1 Contributions or gifts by corporations. A corporation may deduct from its gross income contributions or gifts to organizations described in section 23 (q) (see § 29.23 (b) (1) for definition of "political subdivision"). Where payment is made in a taxable year beginning prior to the first taxable year beginning after the date of the cessation of hostilities in the present war, as proclaimed by the President, the charitable deduction prescribed is allowable to corporations even though the gifts or contributions are used outside of the United States or its possessions, for which deduction shall, to the extent provided by that section, be allowed only for the taxable year in which such contributions or gifts are actually paid, regardless of when pledged and regardless of the use to which the funds or contributions were intended for use. The deduction may be carried over to 1945 and succeeding taxable years.

The provisions of the last paragraph of § 29.23 (q)-1, relating to (1) the statement in returns of the name and address of each organization to which a contribution or gift was made and the approximate date of the actual payment of the contribution or gift, (2) the substantiation of the claims for deductions which is required by the Commissioner, and (3) the basis for calculation of the amount of a contribution or gift which is other than money, are equally applicable to claims for deductions of contributions or gifts by corporations under section 23 (q).

[Sec. 23. Deductions from gross income—as amended by secs. 211 (a), 224, Rev. Act 1939; secs. 211, 165 (b), 2d Ed. Rev. Act 1940; sect. 10 (b), Excess Profits Tax Amendments 1941; sec. 203 (a), Rev. Act 1941; sect. 105 (c), 120 (b), deduction (c), 122 (a), 124 (a), 125, 126 (a), 127 (c), 129 (a), 129 (b), 130 (b), Rev. Act 1942.)

In computing net income there shall be allowed as deductions:

(d) Dividends paid by banking corporations. For deduction of dividends paid by certain banking corporations, see section 121. (a) Operating losses. For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

(b) Alimony, etc., payments. In the case of a husband described in section 22 (c),
amounts includible under section 22 (k) in the gross income of the husband which is made within the husband's taxable year. If the amount of any such payment is, under section 22 (k) or section 171, stated to be not includible in such husband's gross income, no deduction shall be allowed with respect to such payment under this subsection. [Footnote to section 22 (k) of the Revenue Act of 1942, as amended by the Excess Profits Tax Amendments 1941, sec. 202 (a), Rev. Act 1941; sec. 10 (b), Excess Profits Tax Amendments 1941; sec. 202 (a); Rev. Act 1941; sec. 105 (c), (d), 123 (a), 125 (a), 127 (a), 127 (b), 128, 134 (d), 156 (b), 163 (b), Rev. Act 1942.)

In computing net income there shall be allowed as deductions:

(1) Bond premium deduction. In the case of a bondholder, the deduction for amortizable bond premium bearable in any taxable year is allowed under section 126 (c). [Section 126 (c).]

(2) Deductions of estate, etc., on account of decedent's deductions. (1) In the case of a person who is the decedent's estate, trust or corporation, the amount of the deductions in respect of a decedent to the extent allowable under that section and in section 22 (k), the maximum deduction for the taxable year shall be not in excess of $2,500 in the case of all other individuals. [In computing net income there shall be allowed as deductions: (2) Deductions of estate, etc., on account of decedent's deductions.]

(3) In the case of a person described in section 126 (a), the amount of the deductions in respect of a decedent to the extent allowable under that section and in section 22 (k), the maximum deduction for the taxable year shall be not in excess of $2,500 in the case of all other individuals. [In computing net income there shall be allowed as deductions: (3) Deductions of estate, etc., on account of decedent's deductions.]

(4) Medical, dental, etc., expenses. Except as limited under paragraph (1) or (2), expenses paid during the taxable year, not compensated for before, for medical care, as used in this subsection, shall include amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body (including amounts paid for accident or health insurance). [Section 22 (k) (c).]

(5) An individual who files a joint return may deduct only such expenses as exceed 5 per centum of the net income of the taxpayer, computed without the benefit of this subsection, and the maximum deduction for the taxable year shall be not in excess of $2,500 in the case of such husband and wife. [Section 22 (k) (c).]

(6) An individual who files a separate return may deduct only such expenses as exceed 5 per centum of the net income of the taxpayer, computed without the benefit of this subsection, and the maximum deduction for the taxable year shall be not in excess of $2,500 in the case of the head of a family, and $5,000 in the case of all other individuals. [Section 22 (k) (c).]

§ 29.23 (c)–1. Medical, dental, etc., expenses. Section 23 (x) permits a deduction from gross income of payments for certain medical expenses. The deduction is allowable only to individuals and amounts actually paid during the taxable year, regardless of whether the deduction is taken in respect of any one of the terms "medical care" as used in this subsection, and the maximum deduction for the taxable year shall be not in excess of $2,500 in the case of the head of a family, and $5,000 in the case of all other individuals. [Section 22 (k) (c).]

The term "medical care" as used in this subsection, and in section 22 (k), includes amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body (including amounts paid for accident or health insurance). Payments for hospitalization insurance, or for membership in an association furnishing cooperative or so-called free-choice medical service, or group hospitalization and
Computation received in 1942 $100
Less: Portion allowable to the deduction allowed for prior years 1943 $20
(
(deduction for 1942)
200 (payment x (compensation not compensated for in 1942) 20
50 (amount paid or incurred in 1942) 50

Amount to be excluded from gross income for 1943 $0
Taxable income for 1943 $0

Section 23 progresses from excess income as amended by act of August 16, 1942, 56 Stat. 1797; act of 1940; sec. 10 (b), Excess Profits Tax Amendments 1941; sec. 229 (b), Rev. Act 1941; sec. 152 (c), 120 (a), 121 (c) (2), 122 (d) (3), 124 (a), 125, 128 (b), 127 (c) (2), 123, 124 (d), 163 (b), 162 (b), Rev. Act 1912.

In computing net income there shall be allowed as deductions:
(1) Amounts representing taxes and interest paid to cooperative apartment corporation—(1) In general. In the case of a tenant-stockholder (as defined in paragraph (c)) (1) an amount equal to the amount of the real estate taxes on the apartment building and the land on which it is situated, allowable deductions under section (c), paid or incurred by the corporation or the amount of the rental deficit or illness, are deductible.

In the case of a tenant-stockholder (as defined in paragraph (c)) (1) an amount equal to the amount of the real estate taxes on the apartment building and the land on which it is situated, allowable deductions under section (c), paid or incurred by the corporation or the amount of the rental deficit or illness, are deductible.

In the case of a tenant-stockholder (as defined in paragraph (c)) (1) an amount equal to the amount of the real estate taxes on the apartment building and the land on which it is situated, allowable deductions under section (c), paid or incurred by the corporation or the amount of the rental

In the case of a tenant-stockholder (as defined in paragraph (c)) (1) an amount equal to the amount of the real estate taxes on the apartment building and the land on which it is situated, allowable deductions under section (c), paid or incurred by the corporation or the amount of the rental

In the case of a tenant-stockholder (as defined in paragraph (c)) (1) an amount equal to the amount of the real estate taxes on the apartment building and the land on which it is situated, allowable deductions under section (c), paid or incurred by the corporation or the amount of the rental deficit or illness, are deductible.

In the case of a tenant-stockholder (as defined in paragraph (c)) (1) an amount equal to the amount of the real estate taxes on the apartment building and the land on which it is situated, allowable deductions under section (c), paid or incurred by the corporation or the amount of the rental deficit or illness, are deductible.

In the case of a tenant-stockholder (as defined in paragraph (c)) (1) an amount equal to the amount of the real estate taxes on the apartment building and the land on which it is situated, allowable deductions under section (c), paid or incurred by the corporation or the amount of the rental deficit or illness, are deductible.

In the case of a tenant-stockholder (as defined in paragraph (c)) (1) an amount equal to the amount of the real estate taxes on the apartment building and the land on which it is situated, allowable deductions under section (c), paid or incurred by the corporation or the amount of the rental deficit or illness, are deductible.

In the case of a tenant-stockholder (as defined in paragraph (c)) (1) an amount equal to the amount of the real estate taxes on the apartment building and the land on which it is situated, allowable deductions under section (c), paid or incurred by the corporation or the amount of the rental deficit or illness, are deductible.

In the case of a tenant-stockholder (as defined in paragraph (c)) (1) an amount equal to the amount of the real estate taxes on the apartment building and the land on which it is situated, allowable deductions under section (c), paid or incurred by the corporation or the amount of the rental deficit or illness, are deductible.

In the case of a tenant-stockholder (as defined in paragraph (c)) (1) an amount equal to the amount of the real estate taxes on the apartment building and the land on which it is situated, allowable deductions under section (c), paid or incurred by the corporation or the amount of the rental deficit or illness, are deductible.

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In the case of a tenant-stockholder (as defined in paragraph (c)) (1) an amount equal to the amount of the real estate taxes on the apartment building and the land on which it is situated, allowable deductions under section (c), paid or incurred by the corporation or the amount of the rental deficit or illness, are deductible.

In the case of a tenant-stockholder (as defined in paragraph (c)) (1) an amount equal to the amount of the real estate taxes on the apartment building and the land on which it is situated, allowable deductions under section (c), paid or incurred by the corporation or the amount of the rental deficit or illness, are deductible.
The fact that the right to continue to occupy the apartment is dependent upon the payment of rent, the tenant-stockholder is not entitled to a deduction from the corporation in the nature of rentals or assessments for the building or the land on which it is situated which is attributable to the apartment which such individual is entitled to occupy.

The term "tenant-stockholder" means an individual who is a stockholder in a cooperative apartment corporation as defined in section 23 (a), and whose stock is fully paid up in an amount at least equal to an amount shown to the satisfaction of the Commissioner as bearing a reasonable relationship to the portion of the fair market value, as of the date of the original issuance of the stock, of the corporation's equity in the building and the land on which it is situated. The facts are the same as in example (1) except that the building constructed by the X Corporation was a cooperatively owned corporation containing, in addition to the 10 apartments, business space on the ground floor, the corporation rented at $2,400 for the calendar year 1941; the corporation deducted the $3,400 from its expenses in determining the amount of the expenses to be prorated among its tenant-stockholders; the amount paid by A to the corporation in 1942 was $1,140 instead of $1,140. A is entitled under section 23 (a) to a deduction of $622.17 in computing his net income for 1942. The deduction computed as follows:

| Shares of stock of X Corporation owned by A | 100 |
| Shares of stock of X Corporation owned by 9 other tenant-stockholders | 900 |
| Total shares of stock of X Corporation outstanding | 1,000 |

| Expenses incurred by X Corporation: |
| Real estate taxes | $4,000 |
| Interest | 5,000 |
| Maintenance | 3,000 |
| Other expenses | 1,800 |
| Total expenses | $13,800 |

Amount paid by A representing his proportionate share of such expenses (900/1380) | $900 |

A's proportionate share of real estate taxes and interest based on his stock ownership (900/1380) | $900 |

Amount of A's payment representing real estate taxes and interest (900/1380 of $1,380) | $900 |

A's allowable deduction | $900 |

Since the portion of A's payment allocable to real estate taxes and Interest is only $622.17, that amount instead of $900 is allowable as a deduction in computing A's net income for 1942.

EXAMPLE 1. The X Corporation is and at all times since 1940 has been, a cooperative apartment corporation within the meaning of section 23 (a). In 1940 it purchased a site and constructed thereon a building with 10 apartments and a total building cost of $200,000. The fair market value of the land and building was $200,000 at the time of completion of the building. Each apartment is of equal value. Upon completion of the building, the X Corporation mortgaged the land and building for $100,000, and sold its total authorized capital stock, consisting of 1,000 shares of common stock, for $100,000. The stock was purchased by 10 individuals, each of whom was issued a certificate for 100 shares that provides that the holder thereof is entitled to a lease of particular apartment in the building for a term of years.

Amount paid by 10 tenant-stockholders | $10,000 |

Total amount paid by A | $1,000.00 |

A's proportionate share of real estate taxes and interest based on his stock ownership (1/10 of $900) | $90.00 |

A's proportionate share of total corporate expenses based on his stock ownership (1/10 of $900) | $90.00 |

Example 3. The facts are the same as in example (2) except that the amount paid by A to the X Corporation in 1945 is $1,140 instead of $1,140. A is entitled under section 23 (a) to a deduction of $622.17 in computing his net income for 1942. The deduction computed as follows:

| Shares of stock of X Corporation owned by A | 100 |
| Shares of stock of X Corporation owned by 9 other tenant-stockholders | 900 |
| Total shares of stock of X Corporation outstanding | 1,000 |

| Expenses incurred by X Corporation: |
| Real estate taxes | $4,000 |
| Interest | 5,000 |
| Maintenance | 3,000 |
| Other expenses | 1,800 |
| Total expenses | $13,800 |

Amount paid by A representing his proportionate share of such expenses (900/1380) | $900 |

A's proportionate share of real estate taxes and interest based on his stock ownership (900/1380) | $900 |

Amount of A's payment representing real estate taxes and interest (900/1380 of $1,380) | $900 |

A's allowable deduction | $900 |

Since the portion of A's payment allocable to real estate taxes and Interest is only $622.17, that amount instead of $900 is allowable as a deduction in computing A's net income for 1942.

EXAMPLE 23. TRANSFERRED CORPORATE TERRITORY (as amended by secs. 129, 130, 133). (3) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;

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

(5) 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;

(6) Any amount otherwise allowable as a deduction which is allocable to one or more classes of income other than interest (wholly or partially), or of any person financially interested in income or classes is received or accrued) wholly exempt from the taxes imposed by this chapter, or any amount otherwise allowable under section 23 (a) (2) which is allocable to interest (whether or not any amount of such interest income is received or accrued) exempt from the taxes imposed by this chapter.

Amount paid or accrued in connection with the purchase or ownership of stock in a cooperative apartment corporation, in computing net income no deduction shall in any case be allowable as a deduction in computing A's net income for 1942.

Income no deduction shall in any case be allowable as a deduction in computing A's net income for 1942.

Amount paid or accrued in connection with the purchase or ownership of stock in a cooperative apartment corporation, in computing net income no deduction shall in any case be allowable as a deduction in computing A's net income for 1942.

EXAMPLE 3. The facts are the same as in example (2) except that the amount paid by A to the X Corporation in 1945 is $1,140 instead of $1,140. A is entitled under section 23 (a) to a deduction of $622.17 in computing his net income for 1942. The deduction computed as follows:

| Shares of stock of X Corporation owned by A | 100 |
| Shares of stock of X Corporation owned by 9 other tenant-stockholders | 900 |
| Total shares of stock of X Corporation outstanding | 1,000 |

| Expenses incurred by X Corporation: |
| Real estate taxes | $4,000 |
| Interest | 5,000 |
| Maintenance | 3,000 |
| Other expenses | 1,800 |
| Total expenses | $13,800 |

Amount paid by A representing his proportionate share of such expenses (900/1380) | $900 |

A's proportionate share of real estate taxes and interest based on his stock ownership (900/1380) | $900 |

Amount of A's payment representing real estate taxes and interest (900/1380 of $1,380) | $900 |

A's allowable deduction | $900 |

Since the portion of A's payment allocable to real estate taxes and Interest is only $622.17, that amount instead of $900 is allowable as a deduction in computing A's net income for 1942.
allowed in respect of losses from sales or exchanges of property, directly or indirectly—

(a) Exclusion of a family, as defined in paragraph (2) (D);

(b) Except in the case of distributions in liquidation, any corporation more than 50 per cent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

(c) Except in the case of distributions in liquidation, between two corporations more than 50 per cent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

(d) Except in the case of distributions in liquidation, between two corporations more than 50 per cent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

(e) Exclusion of a family, as defined in paragraph (2) (D);

(f) Except in the case of distributions in liquidation, any corporation more than 50 per cent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

(g) Except in the case of distributions in liquidation, between two corporations more than 50 per cent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

(h) Except in the case of distributions in liquidation, between two corporations more than 50 per cent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

(i) Except in the case of distributions in liquidation, any corporation more than 50 per cent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

(j) Except in the case of distributions in liquidation, between two corporations more than 50 per cent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

(k) Except in the case of distributions in liquidation, between two corporations more than 50 per cent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

(l) Except in the case of distributions in liquidation, any corporation more than 50 per cent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

(m) Of section 23 for the purpose of computing the net income of an estate or trust used solely for the benefit of such State, Territory, District of Columbia, possession of the United States, or foreign country for the purpose of computing the income to which such holding is attributable.

(e) Tax withheld on tax-free covenant bonds. For nondeductibility of tax withheld on tax-free covenant bonds, see section 153 (a) (3).

§ 29.24-1 Personal and family expenses. Insurance paid on a dwelling owned and occupied by a taxpayer is a personal expense and not deductible. Premiums paid for life insurance by the insured are not deductible. In the case of a professional man who rents a property for residential purposes, but incidentally receives clients, patients, or other earnings 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 property for the purpose of renting it to tenants as a separate business as is properly attributable to such office is deductible. If the father is entitled to the services of his minor children, any allowances which he gives them, whether directly or indirectly, are not deductible. In consideration of services or otherwise, are not allowable deductions in his return of income. Amounts paid as damages for breach of promise to marry, attorneys' fees and other costs of suit to recover such damages, and attorneys' fees paid in a suit for separation are not deductible from gross income. Amounts paid as support upon divorce or separation are not deductible except as provided in section 23 (a).

§ 29.24-2 Capital expenditures. Amounts paid for increasing the capital value or for making good the depreciation (for which a deduction has been made) of property are not deductible from gross income. (See section 23 (D).) 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 cost of architect's services is part of the cost of the building. Amounts paid by reason of the death of the officer or employee insured are not deductible from the taxpayer's gross income. If, however, the taxpayer is not a beneficiary under such a policy, the premiums so paid will not be disallowed as deductions merely because the decedent's estate may derive a benefit from the increased efficiency of the officer or employee insured. (See §§ 29.23 (a)-3 and 29.23 (b)-3 and in the case of certain transferors as provided in §§ 29.22 (b) (3) and in the case of a spouse to whom such proceeds are income under sections 22 (D). See generally section 22 (b) (1) and §§ 29.22 (b) (1) and 29.23 (b) (2)-3.)

§ 29.24-3 Premiums on business insurance. Premiums paid by a taxpayer on an insurance policy on the life of an officer, employee, or other individual financially interested in the taxpayer's business, for the purpose of protecting the taxpayer from loss in the event of the death of the officer or employee insured are not deductible from gross income whether the beneficiary is an individual or a corporation. In the case of certain transferors as provided in §§ 29.22 (b) (2)-3 and in the case of a spouse to whom such proceeds are income under sections 22 (D). See generally section 22 (b) (1) and §§ 29.22 (b) (1) and 29.23 (b) (2)-3.)

§ 29.24-4 Amounts allocable to exempt income, other than interest—(a) Class of exempt income. As used in this section, the term "class of exempt income" includes any class of income allocable to exempt income but not including interest only to the extent that amounts otherwise allocable under section 23 (a) (2) are allocable thereto (whether or not any amount of income from such class is qualified income, taxfree, or both), wholly exempt from the taxes imposed by chapter 1. Included are any item or class of income, including interest, only to the extent that amounts otherwise allocable to such income but not allocable thereto, constitutionally exempt from the taxes imposed by chapter 1; any item or class, as above defined,
excluded from gross income under any section 24 (a) (5) is to segregate the exempt income from the computation of gross income; and the provisions of any other law from the taxes imposed by section 22 or section 14946 from the computation of deductions un-

The object of section 24 (a) (5) is to segregate the exempt income from the total amount of the taxpayer's income for a particular year. The taxpayer shall keep such records as will enable him to make the allocations required by paragraph (c) of this section, be treated as chargeable to capital account, and included in gross income. Thus, taxes and carrying charges with respect to property, of the type described in this section, are chargeable to capital account at the election of the taxpayer, notwithstanding that they are expressly deductible under section 23. No deduction is permitted for any items so treated.

(b) Taxes and carrying charges. The following items for the production of income wholly exempt from tax. Accordingly, just as exempt items of income are excluded from the computation of gross income under section 22, so section 24 (a) (5) excludes from the computation of the basis of the apportionment. Such statement shall also recite that each deduction claimed in the return is not in any way referable to exempt income. The taxpayer shall keep such records as will enable him to make the allocations required by this section (see section 54).

§ 2924-5 Taxes and carrying charges chargeable to capital account and treated as capital items—(a) General. In accordance with section 24 (a) (7), items enumerated in paragraph (b) of this section may be capitalized at the election of the taxpayer. Thus, taxes and carrying charges with respect to property, of the type described in this section, are chargeable to capital account at the election of the taxpayer, notwithstanding that they are expressly deductible under section 23. No deduction is permitted for any items so treated.

(b) Taxes and carrying charges. The following items for the production of income wholly exempt from tax. Accordingly, just as exempt items of income are excluded from the computation of gross income under section 22, so section 24 (a) (5) excludes from the computation of the basis of the apportionment. Such statement shall also recite that each deduction claimed in the return is not in any way referable to exempt income. The taxpayer shall keep such records as will enable him to make the allocations required by this section (see section 54).

Example (1). A in 1942 and 1943 pays annual taxes and interest on a mortgage on a piece of vacant and unproductive property. Throughout 1943 he operated a parking lot. A may capitalize the taxes and mortgage interest paid in 1942 but not the taxes and mortgage interest paid in 1943, Example (2). X is not entitled to capitalize the interest on a building loan. X in 1943 paid $4,000 social security taxes and $8,000 In-

Example (4). X in 1943 began the erection of a building for himself. X in 1941 paid $8,000 social security taxes in connection with the erection of the building, which in his 1942 return he elected to capitalize. X must continue to capitalize the social security taxes paid in connection with the erection of this building until its completion in 1944. Example (5). A in 1943 paid $3,000 social security taxes on the labor for transportation
shall be allocated to each item. Appor-
tionment must in all cases be reasonable.

Example. A, the owner of a factory on
which a new addition is under construction,
bought on July 6, 1942 pays its general ac-
tount a total of $4,000 and social security taxes of $500
measured thereby. B spends nine tenths of
the time in the factory and the remaining tenth
in superintending the construction work. A treats as expenses $3,600
of B's salary and charges the remaining
$500 to capital account. A may also cap-
tilize $50 of the social security taxes,

§ 29.24-6 Losses from sales or ex-
changes between certain classes of
persons—(a) Individuals (including fiduc-
diaries). In the ease of sales or ex-
changes between certain classed indi-
viduals (including fiduciaries) section 24 (b) (1) provides that no deduction shall be allowed with respect to losses arising therefrom in the hands of members of a family as described in section 24 (b) (2) (D); (2) between fiduciaries of trusts having a common grantor; (3) between a grantor and a beneficiary of a trust; or (4) between a beneficiary of a trust and a beneficiary of such trust.

(b) Corporations (including share-
holders). In the case of sales or ex-
changes of property (except in the cases where a corporation not acting in a fiduciary ca-
pacity is a party to the transaction, sec-
tion 24 (b) (1) also provides that certain expenses shall be deducted with respect to losses arising therefrom in the hands of members of a family as described in section 24 (b) (2) (D); (2) between fiduciaries of trusts having a common grantor; (3) between a grantor and a beneficiary of a trust; or (4) between a beneficiary of a trust and a beneficiary of such trust.

§ 29.24-7 Stock ownership rule. In the transactions of sections 24 (b) (1) (B) it is necessary that there be owned, directly or indirect-
ly, by or for the individual a party to the transactions, either directly or indi-
rectly, a person which held stock of the corporation as defined in section 501, or a foreign personal holding company as defined in section 531, for the taxable year preceding the date of the sale or exchange. It is not nec-

Example (2). On June 15, 1942, of the stock of the N Corporation was owned in
equal proportions by A and B's partner, AP.

§ 29.24-7 Disallowance of deduc-
tions for unpaid expenses and interest. The application of section 24 (a) may be illus-
trated by the following example:

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§ 29.24—8 Life or terminable interests. Amounts paid to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall be subject to any deduction for shrinkage (called depreciation or any other name) in the value of such interest due to the lapse of time. In other words, the holder of such an interest so acquired may not set up the value of the expected future payments as corpus or principal and claim deductions for shrinkage or exhaustion thereof due to the passage of time. (See section 29.24—6.)

No deductions shall be allowed in the case of a life or terminable interest acquired by gift, bequest, or inheritance, if the estate or trust is entitled to a deduction under section 112 (d) for the shrinkage of the income of the life or terminable interest. For example, an estate or a trust in a certain State sells a terminable interest. For example, an interest in his return for the year 1942.

In the case of a life or terminable interest acquired by gift, bequest, or inheritance, if the estate or trust is entitled to a deduction under section 112 (d) for the shrinkage of the income of the life or terminable interest. For example, an estate or a trust in a certain State sells a terminable interest. For example, an interest in his return for the year 1942.

In the case of a life or terminable interest acquired by gift, bequest, or inheritance, if the estate or trust is entitled to a deduction under section 112 (d) for the shrinkage of the income of the life or terminable interest. For example, an estate or a trust in a certain State sells a terminable interest. For example, an interest in his return for the year 1942.

The entire amount received as personal fees may be treated as earned income if the taxpayer is engaged in a professional occupation, such as a doctor or lawyer, even though his employments amount to more than one-half of the time in which personal services and capital are material income-producing factors, a reasonable allowance as compensation in the case of the personal services and capital as material income-producing factors, a reasonable allowance as compensation for the personal services rendered by him to a corporation which represents a reasonable allowance as compensation for the services rendered by him to a corporation which represents a reasonable allowance for the personal services actually rendered. For example, if a taxpayer engaged in a trade or profession in 1942 received $8,000 for services actually rendered by him, his entire net income shall be the entire amount received as professional fees. In the case of a taxpayer engaged in a trade or profession in 1942 received $8,000 for services actually rendered by him, his entire net income shall be the entire amount received as professional fees.

The entire amount received as personal fees may be treated as earned income if the taxpayer is engaged in a professional occupation, such as a doctor or lawyer, even though his employments amount to more than one-half of the time in which personal services and capital are material income-producing factors, a reasonable allowance as compensation for the personal services actually rendered by him to a corporation which represents a reasonable allowance as compensation for the services rendered by him to a corporation which represents a reasonable allowance for the personal services actually rendered. For example, if a taxpayer engaged in a trade or profession in 1942 received $8,000 for services actually rendered by him, his entire net income shall be the entire amount received as professional fees.
Example (1). An individual received income from interest on bonds during the calendar year of $10,000. His allowable deductions under section 2 for that year amounted to $8,000. He is entitled to an earned income credit of $200, computed as follows: 

- Gross income: $10,000
- Allowable deductions: $8,000
- Earned net income: $2,000

Example (2). An individual received a salary of $90,000 as a traveling salesman for the calendar year 1932. His allowable deductions under section 23 for that year amounted to $12,000, of which $2,000 was for traveling expenses in the course of his business and $9,000 was for a loss of his home from fire. His net income is $80,000 minus $12,000, or $68,000. He is entitled to an earned income credit of $800, computed as follows:

- Earned net income before applying limitations in section 23: $80,000
- Allowable deductions: $12,000
- Earned net income after applying limitations: $68,000
- Earned net income as limited to maximum amount prescribed by section 23(a) (4): $60,000
- Earned net income before applying limitation in section 23 (a) (4): $18,000
- Earned net income as limited to maximum amount prescribed by section 23(a) (4): $14,000
- Earned income credit before applying limitation in section 23 (a) (4): $1,400
- Earned income credit as limited by section 23 (a) (4): $1,000
- Earned income credit allowed (10 percent of $90,000 net income): $900

Example (3). During the calendar year 1932 a husband was engaged in a business in which both personal services and capital were income-producing factors. A reasonable allocation for the personal services actually rendered by the taxpayer in the conduct of the business for that year was $10,000. The net profits of the business were $30,000, which constituted his net income for the year. He is entitled to an earned income credit of $700, computed as follows:

- Earned income before applying limitation in section 23 (a) (4): $10,000
- Earned income as limited by section 23 (a) (4): $7,000
- Earned income credit allowed (10 percent of $7,000): $700

In the case of a husband and wife making a joint return, there is but one earned income credit, computed upon the combined income of the spouses, and the maximum and minimum limitations prescribed with respect to such credit shall be based upon the combined income as if the joint return were the return of one individual.

§ 29.25-3 Amount of personal exemption allowable. A single person or a married person not living with husband or wife is entitled to a personal exemption of $350. A head of a family or a married person living with husband or wife is entitled to a personal exemption of $500. A married person living with a child or other dependent is entitled to a personal exemption of $1,200. A married person living with two or more children is entitled to an additional exemption of $350 for each of the two children under 18 years of age. A married person living with a child under 18 years of age who is not a head of a family, or a married person living with a child under 18 years of age, is entitled to a credit of $350 allowed for one such dependent, and the credit for the other dependent is disallowed. If, however, in addition to the two dependents under 18 years of age, the widower also supports and maintains the home of a child who is over 18 years of age and who is not mentally or physically defective, he is entitled to a credit of $350 for each of the two children under 18 years of age, his support and maintenance of the child over 18 years of age is in itself sufficient to give him the status of head of a family, and therefore he does not occupy such status solely by reason of the existence of dependent children under 18 years of age.

§ 29.25-4 Personal exemption of head of family. A head of a family is an individual who actually supports and maintains his dependents. A married person living with his wife is a head of a family if he also supports and maintains his dependent individuals based upon some moral or legal obligation. In the case of spouses who are divorced or legally separated under a decree of divorce or of separate maintenance, periodic payments in the nature of, or in lieu of, alimony or an allowance for support received by one spouse which she is required under section 22 (c) or section 171 (a) to include in gross income and which she uses for support of dependents are considered payments by her for such support and not payments by the other spouse for support of any person. In the absence of continuous actual residence together, whether or not a person with relations is a head of family within the meaning of the Internal Revenue Code must depend upon the character of the separation. If a father is absent on business, 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 applies. If, however, without necessity the dependents continuously makes his home elsewhere, his beneficiary is not the head of a family, irrespective of the question of maintenance. If the husband voluntarily and continuously abandoned the home or wife or husband at a sanatorium or asylum, he is not the head of the family. A married person living with a child or other dependent is not thereby entitled to credit as the head of a family. As to the amount of the exemption, see § 29.25-3.

§ 29.25 Personal exemption of married persons. A married person is entitled to a personal exemption for himself and for each of his or her dependent children under 18 years of age who is a head of a family, and for each of the two children under 18 years of age. The additional exemption may still be allowed. For example, a widower who maintains a house for two dependent children under 18 years of age is entitled to the credit of $350 allowed for each such dependent, and the credit for the other dependent is disallowed. If, however, in addition to the two dependents under 18 years of age, the widower also supports and maintains the home of a child who is over 18 years of age and who is not mentally or physically defective, he is entitled to a credit of $350 for each of the two children under 18 years of age, his support and maintenance of the child over 18 years of age is in itself sufficient to give him the status of head of a family, and therefore he does not occupy such status solely by reason of the existence of dependent children under 18 years of age.

§ 29.25-5 Credit for dependents. A taxpayer, other than a nonresident alien who is not a resident of Canada or Mexico (see section 214), receives a credit of $350 for each person (other than husband or wife), whether related to him by blood, marriage, or adoption, and dependent on him, whether or not dependent upon and receiving his chief support from the taxpayer, provided the dependent is either (a) under 18, or (b) incapable of self support because of physical or mental defect. For credit for dependents in computing tax under Supplement T, see sections 400 and 401.

The credit is based upon actual financial dependency and not merely legal dependency. It may accrue to a taxpayer who is not the head of a family. But a mother whose children receive half or more of their support from a trust fund established for their benefit is not entitled to the credit. In the case of spouses who are divorced or legally separated under a decree of divorce or of separate maintenance, periodic payments (in the nature of, or in lieu of, alimony or allowance for support) received by one spouse which she is required under section 22 (d) or section 171 (a) to include in her gross income and which she uses for support of dependents are considered payments by her for such support and not payments by the other spouse for support of any person.

If a taxpayer occupies the status of the head of a family solely by reason of the existence of one or more dependents for whom he would be entitled to credit under section 25 (b) (2) (A) were it not for section 25 (b) (2) (B), the credits in years of one of such dependents is disallowed. For example, a widower who occupies the status of the head of a family solely by reason of the fact that he is maintaining a boarding house for two dependent children under 18 years of age is entitled to the credit of $350 allowed for one such dependent, and the credit for the other dependent is disallowed. If, however, in addition to the two dependents under 18 years of age, the widower also supports and maintains the home of a child who is over 18 years of age and who is not mentally or physically defective, he is entitled to a credit of $350 for each of the two children under 18 years of age, his support and maintenance of the child over 18 years of age is in itself sufficient to give him the status of head of a family, and therefore he does not occupy such status solely by reason of the existence of dependent children under 18 years of age.

§ 29.25-7 Personal exemption and credit for dependents where status changes. If the status of the taxpayer changes during the taxable year, the personal exemption allowed by section 25 (b) (1) to a single person, a married person not living with husband or wife, a head of a family, or a married person living with husband or wife, and the credit for dependents allowed by section 25 (b) (2) will be apportioned according to the number of months during which the taxpayer occupied each status. A taxpayer not having the status of a head of a family or the status of a married person living with husband or wife shall be considered as having the status of a single person. For the purpose of
the apportionment of the personal exemption and credit for dependents a fractional part of a month shall be disregarded. In general, the personal exemption and credit for dependents allowable for any taxpayer will be the sum of the personal exemptions apportioned to the several periods of the taxable year during which such status was occupied.

The return for the period in which falls the date of the death of a taxpayer is return only for the period during which the taxpayer was alive. The personal exemption and credit for dependents must be determined on the basis of the period for which the return was made. If during such period the status of the taxpayer did not change, the personal exemption and credit for dependents shall be reduced to that proportion of the full credit which the number of months in such period bears to the months.

Example (1). A and B, who were heads of families during the first six months of 1942, were married on July 1, 1942, and lived together during the remainder of the year. If a joint return is filed for A and B on the calendar year basis for 1942, the personal exemption will be $1,200; that is, $200 for A and $1,000 for B for the first six months of 1942, and $1,200 for B while the head of a family, plus $200 for the period during which they were married and living together. If separate returns are made by A and B on the calendar year basis for 1942, each may claim a personal exemption of $600; that is, $200 for A and $400 for B. In this case, however, the joint exemption of $200 might by agreement be taken either by A or B or divided between them in any proportion.

Example (2). A, a widower, qualifies as the head of a family until March 31, 1942, on which date his one dependent child died. September 30, 1942, A dies. The executor or administrator making a return for A may claim a personal exemption of $600; that is, $300 for the period from April 1, 1942, to September 30, 1942, during which period A was the head of a family, and $300 of $500 or $250, for the period from April 1, 1942, to September 30, 1942, during which period A was a single person not the head of a family.

Example (3). A and B were married and living together until November 30, 1942, when B, the head of a family, died. The personal exemption of A and B for the period from January 1, 1942, to November 30, 1942, during which they were married and living together, that is, $400, or $1,000, may by agreement be taken either by B's executor or administrator in behalf of B, or divided between them in any proportion. The personal exemption for the last taxable period of B is the unapportioned personal exemption so taken by B's executor or administrator. If A, the surviving spouse, files a return for the calendar year 1942, he may claim, in addition to his portion of the combined personal exemption, a personal exemption for the period from the date of the death of B to the close of his taxable year, that is, $900.

Example (4). A and B were married and living together until June 30, 1942, when A, the husband, died. The date of death of A was the chief support of a child 10 years of age, B, the surviving spouse, supported this child in her household during the remainder of the year. The executor or administrator in making a return for B is entitled to a personal exemption, to a credit for dependents in the amount of $175; that is, 1% of $350. However, since B qualifies as a head of a family for the last taxable period of A, on account of the fact that she maintained a home for such dependent child, the credit for such dependent is disallowed.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing taxes.

(a) Interest on obligations of the United States and its instrumentalities. The amount received on account of obligations of the United States or of corporations organized under Act of Congress which is allowed to an individual as a credit for purposes of paragraphs (a) (1) or (2). (For reduction of credit under this subsection on account of amortizable bond premium.)

(b) Dividends received. 85 percentum of the amount received as dividends from a domestic corporation plus 5 percentum of the amount received as dividends from a corporation organized under the China Trade Act, 1922, 42 Stat. 849 (U.S.C. Title 18, § 235a, 4) or a corporation which under section 281 is taxable only on its gross income from sources within the United States by reason of its receiving a large percentage of its gross income from sources within the possession of the United States.

(c) Net operating loss of preceding year. (1) Amount of credit. The amount received as dividends from a domestic corporation plus 5 percentum of the amount received as dividends from a corporation organized under the China Trade Act, 1922, 42 Stat. 849 (U.S.C. Title 18, § 235a, 4), or from a corporation which under section 261 is taxable only on its gross income from sources within the United States by reason of its receiving a large percentage of its gross income from sources within the possession of the United States.

The credit allowed by this subsection shall be the amount of the credit for any taxable year not exceed the amount of the credit for any taxable year.

(d) Income subject to excess-profits tax. In the case of any corporation subject to the tax imposed by Subchapter E of Chapter 2, an excess-profits tax shall be allowed to the extent of the excess-profits net income (as defined in section 710 (b)), provided in subsection (e). The credit allowed by this subsection shall be the amount of the credit allowed by subsection (e). The credit allowed by this subsection shall be the amount of the credit allowed by subsection (e).

(e) Definitio ns. As used in this subsection and section 15 (a).

(A) Public utility. The term "public utility" means a corporation engaged in the furnishing of telephone service or in the sale of electric energy, gas, or water, if the revenue derived from such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof or by an agency or instrumentality of the United States or by a public utility or public service commission or other similar body of the District of Columbia or of any State or political subdivision thereof.

(B) Preferred stock. The term "preferred stock" means stock issued prior to October 3, 1924, and designated as preferred by the board of directors of a corporation, or by the terms of the stock certificates, or by the terms of any contract or agreement between the corporation and the stockholders or between the corporation and any other person, or by the terms of any written agreement or memorandum of corporation, which provides for the payment of dividends on such stock prior and in preference to dividends on any other stock of the corporation.
§ 29.26-2 Credit of corporation for net operating loss of preceding year.

Since the net operating loss credit allowed under subsection 26 (c) cannot exceed (a) the section 102 net income for the taxable year, in the case of the tax imposed by section 102; (b) the Supplement P net income for the taxable year, in the case of the computations required under Supplement P; or (c) the subchapter A net income for the taxable year in the case of the tax imposed under subchapter A of chapter 2, it is the smaller of the following amounts:

1. The excess of the deductions allowed by chapter 1 for the preceding taxable year over gross income for such year, determined in accordance with the exceptions and limitations provided by section 26 (e) (2).

2. (i) The section 102 net income for the taxable year, in the cases of the tax imposed by section 102; (ii) the Supplement P net income for the taxable year, in the case of the computations required under Supplement P; (iii) the subchapter A net income for the taxable year, in the case of the tax imposed under subchapter A of chapter 2.

In computing deductions for the preceding taxable year any deduction for depletion shall be computed without reference to discovery value or percentage depletion under section 114 (b) (2), (3), or (4) (see § 29.23 (m)–2). The basis for such depletion is the basis provided in section 113 (a), adjusted as provided in section 113 (b) (1), for the purpose of determining the gain upon the sale or other disposition of the property involved.

In computing deductions for the preceding taxable year the net operating loss provided in section 122 shall not be allowed.

In computing the gross income for the preceding taxable year there must be included the excess, if any, of the amount of any interest received which is wholly exempt from taxes imposed by chapter 1 over the amount of interest paid or accrued which is not allowed as a deduction by section 23 (b), relating to interest on indebtedness incurred or continued to purchase or carry certain tax-exempt obligations.

Example. For 1942 the X Corporation, which makes its income tax returns on the calendar year basis, has a net income of $1,000,000, computed on the accrual basis and without any deduction for the net operating loss provided in section 23 (a). Capital losses of $550,000, and no capital gains. Its Federal normal tax and surtax for 1942, not allowable as a deduction, was $500,000, and it made no contributions during that year. For 1941 its gross income was $550,000, and its allowable deductions were $1,000,000.

Included in such deductions was $200,000 for net operating losses, allowed as a deduction under section 122. There was likewise included in such deductions $400,000 for depletion based on discovery value. Depletion had been computed without reference to discovery value or to percentage depletion, the amount of such depletion having been $100,000. For 1941 the corporation had $300,000 of wholly exempt interest, and paid $200,000 as interest on indebtedness incurred to carry obligations from which such tax-exempt interest was derived. The net operating loss credit allowed to such corporation for 1942 is $700,000.

Deductions for 1941...

Less excess of depletion

deduction computed on
basis of discovery
value over amount
allowable for deple-
tion

$200,000

Less tax-exempt interest

$200,000

Less net operating loss
deduction...

$700,000

Deductions as limited by section 26 (c)...

Less capital losses not

$550,000

Less Federal normal
tax and surtax for

$500,000

Excess of deductions over gross

$500,000

Net income for 1942...

$150,000

The credit for the net operating loss for the preceding year available to the X Corporation for 1942 is $150,000. Inasmuch as the excess of deductions over gross income for 1941, as computed above, is greater than the section 102 net income for 1941 the net operating loss credit available to the X Corporation for 1942 is equal to the section 102 net income for 1941. If the excess of deductions over gross income for 1941, as computed above, were smaller than the section 102 net income for 1942, the entire amount of such excess would be allowed as the net operating loss for 1942.

Similar rules for the computation of the net operating loss credit are applicable in the case of computations required under Supplement P, or the tax imposed under subchapter E of chapter 2.

§ 29.26-3 Bank affiliates. The credit provided in section 26 (d) is allowed:

(a) To a holding company affiliate of a bank, as defined in section 2 of the Banking Act of 1933, which holding company affiliate holds, at the end of the taxable year, a general voting permit granted by the Board of Governors of the Federal Reserve System;

(b) In the amount of the earnings or profits of such holding company affiliate which, in compliance with section 5144 of the Revised Statutes, has been devoted by it during the taxable year to the acquisition of readily marketable assets other than bank stock;

(c) Upon certification by the Board of Governors of the Federal Reserve System to the Commissioner that such an amount of the earnings or profits of the holding company affiliate has been so devoted by such affiliate during the taxable year.

No credit is allowable under section 26 (d) for the amount readily marketable assets other than bank stock which may be acquired by such holding company affiliate under such section 5144 to be acquired by such affiliate, or in excess of the adjusted net income for the taxable year. Nor may the aggregate of the credits allowable under section 26 (d) exceed the amount required to be devoted under section 5144 to the acquisition of readily marketable assets other than bank stock.

Every taxpayer claiming and making a declaration for the credit provided for in section 26 (d) shall attach to its return a supplementary statement, in duplicate, setting forth all the facts and information upon which the claim is predicated, including such facts and information as the Board of Governors of the Federal Reserve System may prescribe as necessary to enable it, upon the request of the Commissioner subsequent to the filing of the return, to certify to the Commissioner the amount of earnings or profits devoted to the acquisition of such readily marketable assets. A certified copy of such supplementary statement shall be forwarded by the taxpayer to the Board of Governors at the time of the filing of the return. The holding company affiliate shall also furnish the Board of Governors such further information as the Board shall require. For the requirements with respect to the amount of such readily marketable assets which must be acquired and maintained by a holding company affiliate to which a voting permit has been granted, see section 5144 (b) and (c) of the Revised Statutes.

§ 29.26-4 Credit for income subject to excess profits tax. A credit is provided in section 26 (e) allowable under sections 13 (a) (2) and 15 (a) in computing normal tax net income and surtax net income, respectively. See section 103 as to certain fiscal years. The credit is allowable only in the case of corporations which are subject to the excess profits tax imposed by subchapter E of chapter 2. The credit does not apply to a corporation exempt from such tax under section 725 (relating to personal service corporations) or section 727 (relating to corporations exempt from excess profits tax).

In general, the credit is the amount of the corporation’s adjusted excess profits net income, as defined in section 710 (b). In the case of the X Corporation, however, the credit is an amount of which the tax imposed by subchapter E of chapter 2 is 90 percent:

(a) Corporations computing such excess profits tax under section 711, relat-
§ 28.26-5 Credit for dividends paid on preferred stock of public utility corporations. The credit provided in section 26 (b) is an amount equal to the dividends paid during the taxable year by certain public utility corporations on certain classes of preferred stock, subject to the following limitations:

(1) The excess profits tax is also determined for the purpose of the credit in the case of such corporations, the excess profits tax being the excess profits net income subject to excess profits tax as defined in section 734 (c). The term "public utility" means a corporation engaged in furnishing of telephone service, or in the sale of electric energy, gas, or water, if the rates charged by such corporation for furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof or by an agency or instrumentality of the United States or by a public utility or public service commission or other similar body of the District of Columbia or of any State or political subdivision thereof.

(2) Corporations computing such excess profits tax for the purpose of the credit in accordance with section 736 (b), shall be subtracted from the basic surtax credit otherwise computed under section 27 (b).

The amount allowable as a credit under section 26 (b) shall be subtracted from the basic surtax credit otherwise computed under section 27 (b).

§ 27. CORPORATION DIVIDENDS PAID CREDIT [as amended by sec. 100 of Pub. L. No. 186, approved Sept. 9, 1939].

(a) Basic surtax credit. The dividend carry-over to the taxable year (if beginning on before, or after January 1, 1939), shall be subtracted from the basic surtax credit otherwise computed under said subsection (c).

(b) Amounts used or irrevocably set aside to pay or to retire indebtedness of any kind, other than that the amounts used or irrevocably set aside to pay or to retire indebtedness of any kind, other than amounts used or irrevocably set aside to pay or to retire indebtedness of any kind, other than dividends on preferred stock, shall be subtracted from the basic surtax credit otherwise computed under section 27 (b).
however, such distributions may contribute to the creation of a deficit by so exhaustively, ceding each distribution profits that they are incapable of absorbing a loss thereafter resulting from the business. It is the subsequent operating loss, however, and not the distribution with the deficit. For example, the X Corporation, which makes its income tax returns on the calendar year basis, has on January 1, 1942, accumulated earnings and profits of $100,000. During 1942 there were no further earnings and profits. On February 1, 1942, operating losses have reduced the accumulated earnings and profits account to $50,000. On March 1, 1942, $50,000 is distributed to shareholders. On April 1, 1942, an operating loss of $40,000 is incurred. There is no further change during the taxable year. Though the corporation closes its year with total assets of $100,000 less than it had on January 1, 1942, and $50,000 of that amount was attributable to operating losses, only $40,000 constitutes a deficit in accumulated earnings and profits for the year. If, however, no operating losses were incurred up to February 1, $90,000 was distributed to shareholders on February 1, and $40,000 operating loss was incurred on March 1, $50,000 operating loss was distributed on April 1, the corporation's deficit in accumulated earnings and profits would be $50,000 as of the close of the year.

§ 23.27 (a)–3 Amounts used or irrevocably set aside to pay or to retire indebtedness.--In the term "indebtedness" means an obligation of a corporation, absolute and not contingent, to pay, on demand or within a given time, in cash or other medium, a fixed amount, existing at the close of business on December 31, 1937, and evidenced by a bond, note, debenture, certificate of indebtedness, mortgage, or deed of trust, issued by the corporation and in existence at the close of business on December 31, 1937, or by a bill of exchange accepted by the corporation prior to, and in existence at, the close of business on December 31, 1937. If the indebtedness evidenced by the amount was used or irrevocably set aside to pay or to retire the principal of indebtedness evidenced by the types of obligations enumerated in that section, the denial of a credit for amounts used or irrevocably set aside to pay interest applicable whether the interest involved became due on, before, or after January 1, 1938. If interest is allowable as a deduction under section 32 (b), (c), or (d) as part of an unmortgage obligation to pay interest applies whether the interest involved became due on, before, or after January 1, 1938. If interest is allowable as a deduction under section 32 (b), (c), or (d) as part of a prior income tax law when paid or accrued or would be so allowable if it were not for the exception contained in such section or section 24 (a), no credit will be allowed under section 24 (a) with respect to such interest, despite the fact that such interest may have been funded and forms part of all the principal amounts of an obligation of the character described in section 27 (a) (4).

(b) Amounts used or irrevocably set aside. The credit is allowable, in any taxable year, only for amounts used or irrevocably set aside in that year. The use or irrevocable setting aside must be to effect the extinguishment or discharge of indebtedness. The issuance of a renewal obligation will, therefore, not result in an allowable deduction if amounts are set aside in one year, no credit is allowable for such amounts for a later year which is actually paid. As long as all other conditions are satisfied, the aggregate amount of credits in any taxable year includes all amounts (from whatever source) used and, as well, all amounts (from whatever source) irrevocably set aside, irrespective of whether in cash or other medium. Double credits are not permitted.

(c) Reasonableness of the amounts with reference to the size and terms of the indebtedness. The reasonableness of the amounts used or irrevocably set aside must be determined by reference to the size and terms of the particular indebtedness. Efforts must be made to provide circumstances with respect to the nature, scope, conditions, amount, maturity, and other terms of the particular indebtedness must be shown in each case. Ordinarily an amount used to pay or retire an indebtedness, in whole or in part, at or prior to the maturity and in accordance with the terms thereof will be considered reasonable, and may be allowable as a credit for the year in which so used, if no adjustment is required by reason of an amount set aside in a prior year for payment or retirement of the same indebtedness. Any amounts irrevocably set aside for the payment or retirement of an indebtedness in accordance with and pursuant to the terms of the obligation, for example, the annual contribution to trusteed by the provisions of a mandatory sinking fund agreement, will be considered as complying with the statutory requirements of reasonableness. To be considered reasonable it is not necessary that the plan of retirement provide for a retroactive setting aside of amounts for years prior to that in which the plan is adopted. However, if a voluntary plan was adopted prior to 1938, no adjustment is allowable in respect of the amounts set aside in the years prior to 1938.

[S. 27, Corporation dividends paid credit—so amended by cong. 223 (a), Rev. Act 1937; cong. 132 (b) (c), Rev. Act 1942.]

(b) Basic surtax credit. As used in this chapter the term "basic surtax credit" means the sum of:

(1) The dividends paid during the taxable year, increased by the amounts dividends credit provided in section 28, and reduced by the amount of the credit provided in section 23 (a) relating to interest on certain obligations of the United States and Government corporations.

(2) The not operating loss credit provided in section 23 (c) (1).

(3) The net operating loss credit provided in section 23 (d) (5).

The aggregate of the amounts under paragraphs (2) and (3) shall not exceed (A) the section 23 (e) net income of the corporation, in the case of the tax imposed by section 162; (B) the Supplement F set income for the taxable year, in the case of the computation required under Supplement F; or (C) the Subchapter A net income for the taxable year, in the case of the tax imposed under Subchapter A.

§ 29.27 (b)–1 Basic surtax credit. The amount constituting the basic surtax credit of a corporation for the taxable year consists of the sum of the following, less the amount allowable as a credit under section 28 (b) (relating to the credit for dividends paid on certain preferred stock of certain public utility corporations), and less the amount allowable as a deduction under section 122 (relating to the deduction of dividends paid on certain preferred stock of certain banks and trust companies):

(a) The dividends paid during the taxable year, subject to the qualifications, limitations, and exceptions provided in section 27 (d) to 27 (I), inclusive, plus the consent dividends credit.
provided by section 28, less the credit for interest on certain obligations of the United States and its instrumentalities, provided by section 26 (a) (3) and the bank affiliate credit provided in section 26 (d).

(b) The smaller of the following:
   (1) The sum of the net operating loss credit for the preceding taxable year provided in section 26 (d), and
   (2) The section 102 net income for the taxable year, in the case of tax imposed by section 102; (ii) the Supplement P net income for the taxable year, in the case of computations required under Supplement P; or (iii) the subchapter A net income for the taxable year, in the case of tax imposed under subchapter A of chapter 2.

§ 29.27 (b)-2 Dividends paid—(a) When dividends are considered paid. A dividend will be considered as paid when it is received by the shareholder. An allowance for dividends paid will not be permitted unless the shareholder receives the dividend during the taxable year for which the credit is claimed.

(b) Methods of accounting. The determination of whether a dividend has been paid to the shareholder by the corporation is in no way dependent upon the method of accounting regularly employed by the corporation in keeping its books or upon the method of accounting upon the basis of which the income tax return of the corporation is computed. See section 43.

(c) Records. Every corporation claiming an allowance for dividends paid shall keep as permanent records as are necessary (1) to establish that the dividends with respect to which such allowance is claimed were actually paid during the taxable year and (2) to supply the information required by section 43 to enable the department to determine whether the dividend was paid to the shareholder within the taxable year; a presumption arises that the dividend was paid to the shareholder in such year.

The payment of a dividend during the taxable year to the authorized agent of the shareholder will be deemed payment of the dividend to the shareholder during such year.

If a corporation, instead of paying the dividend directly to the shareholder, credits the account of the shareholder on the books of the corporation with the amount of the dividend, payment for a dividend paid will not be permitted unless it is shown to the satisfaction of the Commissioner that such crediting constituted payment of the dividend to the shareholder within the taxable year.

In the case of a stock dividend, if the shares (other than fractional shares payable to bearer) constituting the dividend are not entered or registered on the books of the corporation in the name of the shareholder (or his nominee or transferee) within the taxable year, the dividend will not be deemed to have paid in such year. Delivery of a certificate, or certificates, for such new shares, within the taxable year, constitutes prima facie evidence of the payment of the dividend.

If the dividend is payable in obligations of the corporation, they shall be entered or registered in the taxable year on the books of the corporation, in the name of the shareholder (or his nominee or transferee), and, in the case of obligations payable to bearer, should be received in the taxable year by the shareholder (or his nominee or transferee), then the dividend is considered as paid when such deducting and withholding occur.

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(a) If the basic surtax credit for the first preceding taxable year exactly equals the subchapter A net income for such year, the dividend carry-over is the amount of the excess of the basic surtax credit for the second preceding taxable year over the subchapter A net income for such year.

(b) The basic surtax credit for the first preceding taxable year exceeds the subchapter A net income for such year, the dividend carry-over is the amount of such excess plus the excess of the basic surtax credit for the second preceding taxable year over the subchapter A net income for such year.

(c) If the basic surtax credit for the first preceding taxable year is less than the subchapter A net income for such year, the dividend carry-over is the amount by which the basic surtax credit for the second preceding taxable year exceeds the subchapter A net income for such year.

The dividend carry-over is the amount by which the basic surtax credit for the second preceding taxable year exceeds the subchapter A net income for such year, since the excess of the subchapter A net income for the first preceding taxable year over the sum of the basic surtax credit for such year and the excess of the subchapter A net income for the third preceding taxable year over the subchapter A net income for such year.

(Example) The X Corporation, which makes its income tax returns on the calendar year basis, has subchapter A net income of $150,000, its subchapter A basic surtax credit is $200,000 and its basic surtax credit is $350,000, and for 1941 its subchapter A net income and its basic surtax credit are each $175,000. Its dividend carry-over to 1942 is $150,000, computed as follows:

1. Basic surtax credit for 1940—$350,000
2. Less subchapter A net income for 1940—$150,000
3. Dividend carry-over to 1942—$200,000

§ 29.27 (c)-1 Dividend carry-over. The dividend carry-over to a given taxable year is computed as follows:

- The dividend carry-over to a given taxable year shall be determined as if the corporation was, under the law applicable to such taxable year, a personal holding company.

- Every corporation claiming a dividend carry-over for any taxable year shall file with its return for such year a concise statement setting forth the amount of the dividend carry-over claimed, the date of the dividend carry-over and the amount thereof, including a detailed schedule showing the computation of the dividend carry-over claimed.

The computation of the dividend carry-over may be illustrated by the following examples:

Example (1). The X Corporation, which makes its income tax returns on the calendar year basis, has subchapter A net income of $150,000, its subchapter A basic surtax credit is $200,000; and for 1941 its subchapter A net income and its basic surtax credit are each $175,000. Its dividend carry-over to 1942 is $150,000, computed as follows:

1. Basic surtax credit for 1940—$350,000
2. Less subchapter A net income for 1940—$150,000
3. Dividend carry-over to 1942—$200,000

Since the basic surtax credit for 1941 exactly equals the subchapter A net income for such year, the dividend carry-over is the excess of the basic surtax credit for the second preceding taxable year over the subchapter A net income for such year.

The sum of the net operating loss credit for the preceding taxable year provided in section 25 (d).
for such year, in which case it operates to reduce the amount of such excess which must be deducted from the carry-over from the second preceding taxable year (1940).

Example (2). The X Corporation, which makes its income tax returns on the calendar year basis, has subchapter A net income of $100,000 and a basic surtax credit of $150,000 for 1939. For 1940 its subchapter A net income is $150,000 and its basic surtax credit is $70,000, and for 1941 its subchapter A net income and its basic surtax credit are $250,000 and $100,000, respectively. Its dividend carry-over to 1942 is $65,000, computed as follows:

Year 1940

(1) Basic surtax credit .......... $75,000
(2) Less subchapter A net income .......... $100,000
(3) Excess of basic surtax credit over subchapter A net income ........... $25,000

Year 1941

(4) Basic surtax credit .......... $100,000
(5) Less subchapter A net income .......... $25,000
(6) Excess of basic surtax credit over subchapter A net income ........... $75,000

(7) Dividend carry-over to 1942 (sum of (5) and (6)) .......... $100,000

For the reason why the year 1939 is not taken into account, see explanation at end of example (1).

Example (3). The Z Corporation, which makes its income tax returns on the calendar year basis, has a subchapter A net income of $90,000, and a basic surtax credit of $150,000 for 1939. For 1940 its subchapter A net income is $50,000, and its basic surtax credit is $160,000, and for 1941 its subchapter A net income and its basic surtax credit are $120,000 and $200,000, respectively. Its dividend carry-over to 1943 is $40,000, computed as follows:

Year 1940

(1) Basic surtax credit .......... $160,000
(2) Less subchapter A net income .......... $120,000
(3) Excess of basic surtax credit over subchapter A net income ........... $40,000

Year 1941

(4) Subchapter A net income .......... $120,000
(5) Basic surtax credit .......... $25,000

Year 1939

(6) Basic surtax credit .......... $150,000
(7) Less subchapter A net income .......... $90,000
(8) Excess of basic surtax credit over subchapter A net income ........... $60,000

Sum of (6) and (8) .......... $180,000

(9) Excess of subchapter A net income for the first preceding taxable year (1941) over sum of items (5) and (8) .......... $50,000

(10) Dividend carry-over to 1943 (3 minus (9)) .......... $30,000

§ 227 (d) (1) Dividends in kind. Section 27 (d) imposes limitations upon the amount of dividends paid which may be included in the basic surtax credit. Irrespective of the form of the corporate resolution in which a dividend is declared, if the dividend is ultimately and actually paid by the corporation in any property other than money, constituting its corporate assets, the amount of the allowance for dividends paid to which the corporation is entitled with respect thereto cannot exceed the lesser of the two following amounts determined as of the time of payment:

(a) The adjusted basis of such property in the hands of the corporation as provided for in section 113;
(b) The fair market value of such property.

As used in this section the term "property" includes shares of capital stock of the corporation making the dividend distribution if such shares of stock are held by it as an investment. Unless shown to the contrary, shares of capital stock once issued but thereafter acquired by the corporation in any manner whatsoever, but not retired, shall be deemed to be held by the corporation as an investment. The term "property" also includes obligations upon which the corporation making the distribution is liable as a guarantor, endorser, or surety.

The application of section 27 (d) may be illustrated by the following example:

Example. The S Corporation, in 1934, purchased stock of the Y Corporation for $100,000. In 1942 such stock had a fair market value of $700,000. During the period of its ownership of such stock, the S Corporation received distributions amounting to $500,000 out of earnings or profits of the Y Corporation accumulated before March 1, 1935. In 1943 the corporation used such stock for the payment of a dividend. The amount of the additional allowance for inclusion in the basic surtax credit for 1943 is $70,000, computed as follows:

Purchase price, or cost of stock.......... $100,000
Less tax-free distributions .......... $500,000
Adjusted basis of stock in the hands of the corporation at the time of the dividend payment .......... $500,000
Fair market value of stock at the time of the dividend payment .......... $700,000
Allowance for dividends paid for purposes of inclusion in the basic surtax credit for 1943 .......... $70,000

Since the fair market value of the stock ($700,000) at the time of the dividend payment is less than the adjusted basis ($500,000) of the stock in the hands of the corporation at the time of the dividend payment, the lesser amount ($70,000) should be used as the allowance for dividends paid for purposes of computing the basic surtax credit for 1942 with respect to such stock.
The X Corporation, which makes its income tax returns on the calendar year basis, declared a dividend of $85,000 in 1936, payable in described bonds at $15,000 per share. The bonds were issued on January 1, 1913, and were secured by mortgages on real estate. The bonds were redeemable at the option of the corporation at 104, plus accrued interest, at any time on or after February 28, 1936. The bonds were sold at a premium of $10 per share, and the total proceeds were $90,000.

Under section 115 of the Code, the amount of the dividend paid is the total amount paid, less the fair market value of the bonds at the time of issuance, or $75,000. The dividends paid credit for 1936 was the fair market value of the bonds at the time of the dividend payment ($75,000), since such fair market value was lower than the face value ($100,000) of the bonds.

The bonds were redeemed in 1942. The corporation prior to the redemption of the bonds at face value deducted in its returns over the life of the bonds the $10,000 bond discount resulting from the payment in 1936 of the $85,000 dividend in bonds having a face value of $15,000 per share. The dividends paid for purposes of computing the basic surtax credit with respect to the bond redemption for the taxable year 1942, in which the redemption of the bonds occurred, is $100,000, computed as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Redemption price of bonds</td>
<td>$100,000</td>
</tr>
<tr>
<td>Less fair market value of bonds when dividend was paid in 1936</td>
<td>$25,000</td>
</tr>
<tr>
<td>Difference</td>
<td>$25,000</td>
</tr>
</tbody>
</table>

| Amount treated as dividend paid in 1942 | $10,000 |

(§ 29.27 (c)-(1) Dividends paid credit for distributions in liquidation—(a) Distributions which diminish earnings or profits. The Code provides that an allowance for dividends paid is permissible only with respect to taxable dividends paid, section 27 (g) makes one exception, namely, that as a matter of administrative practice, under the Internal Revenue Code, constitutes a distribution of, and is properly chargeable to, earnings or profits accumulated after February 28, 1913. Thus, a distribution by a corporation in complete liquidation of a corporation is treated by the Code as one constituting in part a distribution of, and being properly chargeable to, earnings or profits, if: (1) Under the provisions of section 115 (c), the amounts distributed in liquidation are treated as received in payment in exchange for the stock; and (2) Under the provisions of section 113, the gain or loss, if any, from such exchange is recognized.

In such a case, an allowance for dividends paid may be included in the basic surtax credit for the amount actually involved in such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, even though the method of taxation of the distribution is that ordinarily employed with respect to the gain or loss realized and recognized upon an exchange, rather than that employed with respect to a taxable dividend.

On the other hand, certain transactions described in sections 112 and 115 are treated, for the purposes of the Internal Revenue Code, not as distributions to the shareholders of earnings or profits, but as transfers of such earnings or profits from one corporation to another, and the distribution of such earnings or profits, being available for distribution by it as dividends to its shareholders, have essentially the same status for the purposes of the Code. No allowance for dividends paid may be included in the basic surtax credit for the amount actually involved in such distribution which is properly chargeable to the earnings or profits of the corporation receiving such distribution, less the amount allocable to capital account.

(b) Amount properly chargeable to earnings or profits. In the case of a distribution in liquidation with respect to which an allowance for dividends paid is permissible (see paragraph (a) of this section) the amount of the allowance is equal to the part of the distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913. To determine the amount properly chargeable to the earnings or profits accumulated since February 28, 1913, there must be deducted from the amount of the distribution a capital account, for purposes of these regulations, includes not only amounts representing the par or stated value of the stock with respect to which the liquidating distribution is being made but also that stock's proper share of the paid-in surplus, and such other corporate items, if any, which, for purposes of income taxation, are treated as capital items in that the corporation distributed dividends when distributed but are apportioned against and reduce the basis of the stock. The remainder of the distribution in liquidation is, ordinarily, properly chargeable to earnings or profits accumulted since February 28, 1913.

The application of this paragraph may be illustrated by the following example:

Example. The Y Corporation, which makes its income tax returns on the calendar year basis, was organized on January 1, 1913, with an authorized and outstanding capital stock of 2,000 shares of common stock of a par value of $100 each and 1,000 shares of participating preferred stock of a par value of $100 each. The preferred stock was to receive annual dividends of $2 per share. In 1910 the preferred stock was issued at $100 per share, for a total of $100,000, and the company stock was issued, at $10 per share, for a total of $200,000. On July 15, 1942, the company had a paid-in surplus of $8,000, consisting of the premium received on the preferred stock, earnings or profits accumulated prior to March 1, 1913, and earnings or profits accumulated since February 28, 1913.

To determine the amount of the distribution allocable to capital account, for purposes of these regulations, includes not only amounts representing the par or stated value of the stock with respect to which the liquidating distribution is being made but also that stock's proper share of the paid-in surplus, and such other corporate items, if any, which, for purposes of income taxation, are treated as capital items in that the corporation distributed dividends when distributed but are apportioned against and reduce the basis of the stock. The remainder of the distribution in liquidation is, ordinarily, properly chargeable to earnings or profits accumulted since February 28, 1913.

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The application of this paragraph may be illustrated by the following example:

Example. The Y Corporation, which makes its income tax returns on the calendar year basis, was organized on January 1, 1913, with an authorized and outstanding capital stock of 2,000 shares of common stock of a par value of $100 each and 1,000 shares of participating preferred stock of a par value of $100 each. The preferred stock was to receive annual dividends of $2 per share. In 1910 the preferred stock was issued at $100 per share, for a total of $100,000, and the company stock was issued, at $10 per share, for a total of $200,000. On July 15, 1942, the company had a paid-in surplus of $8,000, consisting of the premium received on the preferred stock, earnings or profits accumulated prior to March 1, 1913, and earnings or profits accumulated since February 28, 1913.

To determine the amount of the distribution allocable to capital account, for purposes of these regulations, includes not only amounts representing the par or stated value of the stock with respect to which the liquidating distribution is being made but also that stock's proper share of the paid-in surplus, and such other corporate items, if any, which, for purposes of income taxation, are treated as capital items in that the corporation distributed dividends when distributed but are apportioned against and reduce the basis of the stock. The remainder of the distribution in liquidation is, ordinarily, properly chargeable to earnings or profits accumulted since February 28, 1913.
poses of the allowance for dividends paid. Any such distribution so allocated shall be treated as a dividend paid only in respect of the computation of the basic surtax credit allowable to the transferor, and must be consistently so treated by both corporations for the current and succeeding years. Each corporation shall file as a part of its return for the taxable year involved (1) a statement setting forth concisely all of the material facts, including the date and the character of the dividend paid or portion thereof, (2) a certified copy of the resolution of the board of directors of the transferor corporation with respect to the distribution. No allowance for dividends paid based upon such appropriation and allocation will be permitted unless it is satisfactorily established that the transferor corporation is entitled thereto pursuant to the provisions of this paragraph and that there has been a full compliance with the requirements of paragraphs (a) and (b) of this section. The provisions of this paragraph may be illustrated by the following examples:

Example. The P Corporation, which makes income tax returns on the basis of a fiscal year ending March 31, owned all of the capital stock of the S Corporation. The S Corporation, which makes its returns on the calendar year basis, paid a dividend, taxable to the P Corporation, on December 15, 1942. At that time, the S Corporation had earnings or profits accumulated subsequent to January 1, 1913, in the amount of $50,000, in addition to earnings or profits of $20,000 for 1920, and an adjusted net income of $45,000. It had paid no dividends prior to its liquidation. The P Corporation had earnings or profits accumulated subsequent to February 28, 1913, in the amount of $20,000, and an adjusted net income of $25,000. No dividend had been paid on December 15, 1942, after the close of the taxable year of the S Corporation. The S Corporation may be allocated to the P Corporation. The dividend paid on December 15 may, by appropriate corporate action, be made as one effecting a distribution out of the current earnings or profits of the S Corporation to the extent of $20,000. No part of that distribution may be allocated to the S Corporation's accumulated earnings or profits since, under section 110 (b), the distribution is deemed to result from liquidation and the S Corporation for the taxable year ($100,000) are sufficient in amount to cover the distributions made during that year ($100,000).

[Sec. 27. Corporation dividends paid during calendar year—amended by sec. 222 (d), Rev. Act 1938; approved March 17, 1941; sec. 123 (b) (d), Rev. Act 1942.]

(ii) Preferential dividends. The amount of any distribution (as defined in section 23 (a) (3)) shall not be considered as dividends paid for the purpose of computing the basic surtax credit, unless such distribution is pro rata, with no preference to any share of stock as compared with other shares of the same class or with any other class of stock, with no preference to one class of stock as compared with another class except to the extent that the former is entitled (without consideration of the voting rights of shareholders) to such preference. For a distribution made in connection with a consent distribution, see section 28.

§ 28.27 (h) Preferential distributions. Section 27 (d) imposes a limitation upon the general rule that a corporation is entitled to an allowance for dividends paid with respect to all dividends which it actually pays during the taxable year. The limitation imposed by section 27 (b) is unqualified, except in the case of a partial distribution (see section 28 (a) (5)) made in connection with a consent distribution as defined in § 28.28 (c). If, in the case of a partial distribution, the corporation distributes a dividend which is qualified under section 27 (b) or which is not part of a full compliance with the requirements of section 27 (d), its basic surtax credit as a dividend paid under section 27 (a) must be treated as a dividend paid only for the purpose of determining the basic surtax credit allowable to the transferor, and must be consistently so treated by both corporations for the current and succeeding years. Each corporation shall file as a part of its return for the taxable year involved (1) a statement setting forth concisely all of the material facts, including the date and the character of the dividend paid or portion thereof, (2) a certified copy of the resolution of the board of directors of the transferor corporation with respect to the distribution. No allowance for dividends paid based upon such appropriation and allocation will be permitted unless it is satisfactorily established that the transferor corporation is entitled thereto pursuant to the provisions of this paragraph and that there has been a full compliance with the requirements of paragraphs (a) and (b) of this section. The provisions of this paragraph may be illustrated by the following examples:

Example. The P Corporation, which makes income tax returns on the calendar year basis, has a capital of $100,000 consisting of 1,000 shares of common stock of a par value of $100 and earnings or profits accumulated after February 28, 1913, in the amount of $50,000. In the year 1942, the N Corporation distributes $75,000 in cancellation of all shares of the stock owned by each of the four shareholders of the corporation. No allowance for dividends paid is permitted under section 27 (h) with respect to such distribution.

Example (2). The N Corporation, which makes income tax returns on the calendar year basis, has a capital of $100,000 consisting of 1,000 shares of common stock of a par value of $100 and earnings or profits accumulated after February 28, 1913, in the amount of $50,000. In the year 1942, the N Corporation distributes $75,000 in cancellation of all shares of the stock owned by each of the four shareholders of the corporation. No allowance for dividends paid is permitted under section 27 (h) with respect to such distribution.

Example (3). The P Corporation has two classes of stock outstanding, 10 shares of cumulative preferred, owned by E, entitled to $5 per share and on which no dividends have been paid for two years, and 10 shares of common, owned by F. On December 31, 1942, the corporation distributes a dividend of $50,000, $30 to E and $25 to F. The corporation is entitled to an allowance for any part of such dividend paid, since it is entitled to a preference to E. However, the corporation has distributed $100 to E and $25 to F, and it has been excluded, in computing the corporation's basic surtax credit, as a dividend. See section 27 (c), Corporation dividends paid and cumulative preferred stock. The corporation may be included in the basic surtax credit as a dividend paid only for the purpose of determining the basic surtax credit allowable to the transferor, and must be consistently so treated by both corporations for the current and succeeding years. Each corporation shall file as a part of its return for the taxable year involved (1) a statement setting forth concisely all of the material facts, including the date and the character of the dividend paid or portion thereof, (2) a certified copy of the resolution of the board of directors of the transferor corporation with respect to the distribution. No allowance for dividends paid based upon such appropriation and allocation will be permitted unless it is satisfactorily established that the transferor corporation is entitled thereto pursuant to the provisions of this paragraph and that there has been a full compliance with the requirements of paragraphs (a) and (b) of this section. The provisions of this paragraph may be illustrated by the following examples:

Example (4). The P Corporation, which makes income tax returns on the calendar year basis, has a capital of $100,000 consisting of 1,000 shares of common stock of a par value of $100 and earnings or profits accumulated after February 28, 1913, in the amount of $50,000. In the year 1942, the N Corporation distributes $75,000 in cancellation of all shares of the stock owned by each of the four shareholders of the corporation. No allowance for dividends paid is permitted under section 27 (h) with respect to such distribution.

Example (5). The P Corporation has two classes of stock outstanding, 10 shares of cumulative preferred, owned by E, entitled to $5 per share and on which no dividends have been paid for two years, and 10 shares of common, owned by F. On December 31, 1942, the corporation distributes a dividend of $50,000, $30 to E and $25 to F. The corporation is entitled to an allowance for any part of such dividend paid, since it is entitled to a preference to E. However, the corporation has distributed $100 to E and $25 to F, and it has been excluded, in computing the corporation's basic surtax credit, as a dividend. See section 27 (c), Corporation dividends paid and cumulative preferred stock. The corporation may be included in the basic surtax credit as a dividend paid only for the purpose of determining the basic surtax credit allowable to the transferor, and must be consistently so treated by both corporations for the current and succeeding years. Each corporation shall file as a part of its return for the taxable year involved (1) a statement setting forth concisely all of the material facts, including the date and the character of the dividend paid or portion thereof, (2) a certified copy of the resolution of the board of directors of the transferor corporation with respect to the distribution. No allowance for dividends paid based upon such appropriation and allocation will be permitted unless it is satisfactorily established that the transferor corporation is entitled thereto pursuant to the provisions of this paragraph and that there has been a full compliance with the requirements of paragraphs (a) and (b) of this section. The provisions of this paragraph may be illustrated by the following examples:

Example (6). The P Corporation, which makes income tax returns on the calendar year basis, has a capital of $100,000 consisting of 1,000 shares of common stock of a par value of $100 and earnings or profits accumulated after February 28, 1913, in the amount of $50,000. In the year 1942, the N Corporation distributes $75,000 in cancellation of all shares of the stock owned by each of the four shareholders of the corporation. No allowance for dividends paid is permitted under section 27 (h) with respect to such distribution.

The effect of sections 27 (h) and (i) is that no allowance for dividends paid may be included in the basic surtax credit unless such allowance is allocated to the shareholder unless each of the shareholders of that class, who are subject to taxation under chapter 1 for the period in which the distribution is made, receives a taxable divi-
The application of section 27 (1) may be illustrated by the following examples:

Example (1). A, B, C, and D are the shareholders of A Corporation, which according to its income tax returns on the calendar year basis, D being an educational corporation exempt from this section. On July 15, 1942, the Y Corporation paid a dividend (within the meaning of section 116) in cash of $1,000. A and B make their returns on the calendar year basis, but C and D make his return on the basis of the fiscal year ending July 31. The Y Corporation is entitled to an allowance for dividends paid in the amount of $1,000 with respect to the dividends paid on July 15.

Example (2). If the facts in the preceding example are the same, except that A and B make their returns on the basis of the fiscal year ending July 31, the Y Corporation is entitled to an allowance for dividends paid in the amount of $1,000 with respect to the dividends paid on July 15.

The same result would follow if the order of preferences were class A 6 percent, only class B stock would be consent stock. The same result would follow if the order of preferences were class A $3 per share, after which class B, consisting of 600 shares, were owned by A, and class B stock were consent stock.

As used in this section—

(1) Partial distribution. The term "partial distribution," as defined in section 28 (a), (5), does not include any actual distributions but is limited to the hypothetical distribution evidenced by shareholders' consents. The consent distribution equals the aggregate of all the amounts specified in the shareholders' consents. If actually distributed, such amounts would have constituted in whole or in part a return of capital. Section 28 (a) (5) may be illustrated by the following example:

Example. The X Corporation, which makes its income tax returns on the calendar year basis, has only one class of stock outstanding, consisting of 600 shares, 200 of which are owned by A, and 400 by B. On December 16, 1942, the corporation distributes $1,500 in cash of which $1,000 will be deemed to have made a consent distribution of $1,500 on December 16.

As used in this section—

(5) Partial distribution. The term "partial distribution," as defined in section 28 (a) (5), does not include preferred dividends even though payable on consent stock. The application of section 28 (a) (5) may be illustrated by the following example:

Example. The X Corporation, which makes its income tax returns on the calendar year basis, has only one class of stock outstanding, consisting of 600 shares, 200 of which are owned by A, and 400 by B. On December 16, 1942, the corporation distributes $1,500 in cash of which $1,000 will be deemed to have made a consent distribution of $1,500 on December 16.
to the extent of $1,500 paid on class A stock, is a partial distribution.

[Sec. 28. Consent dividends credited—amended by sec. 28 (b) (1) of Act.] (a) Definitions. As used in this section—

(1) Preference. The term "preference distribution" means a distribution which is not pro rata, or which is with preference to any share of stock as compared with other shares of the same or of any other class of stock, or to any class of consent stock as compared with any other class of consent stock.

§ 29.28 (b) (1) Payment of preferred dividends. Section 28 (b) (1) provides that a corporation shall not be entitled to a partial distribution for any taxable year, regardless of compliance with other requirements of section 28, unless at the close of such year all preferred dividends for the taxable year (but if cumulated for prior taxable years) have been paid. Whatever form such payment takes, it must result in the complete discharge of the obligation of the corporation to preferential dividends. For what constitutes payment of a dividend before the close of the taxable year, see § 29.27 (b) (2). For what constitutes a preferred dividend see section 28 (a) (2). A preferred dividend will be considered paid for the purposes of this requirement, even though it is paid as part of a preference dividend as defined in section 27 (b), and the corporation receives no credit for dividends paid in consequence thereof.

§ 29.28 (b) (2) Liquidation of consent stock. A corporation is not entitled to a consent dividends credit for any taxable year in which it has taken any steps in, or in pursuance of, a plan of complete or partial liquidation of all or any part of the consent stock.

Example. The X Corporation, which makes its income tax returns on the calendar year basis, has only one class of stock outstanding, owned in equal amounts by A and B. A and B each receive a distribution in cash and each share of class B stock (consent stock) is canceled or redeemed. The corporation is barred from accepting a consent dividends credit for the taxable year, regardless of compliance with other requirements of section 28. If, however, class A stock (not consent stock), instead of class B consent stock, is canceled or redeemed in the liquidation, the corporation would not be barred, because of such liquidation, from obtaining a consent dividends credit.

The mere purchase by a corporation of its own stock for investment is not, within the meaning of section 28 (b) (2), the taking of any step in, or in pursuance of, a plan of complete or partial liquidation and will not prevent a corporation from obtaining a consent dividends credit for the taxable year.

[Sec. 28. Consent dividends credited—amended by sec. 28 (b) (2) of Act] (c) Allocations of credit. There shall be allowed to the corporation, as a part of its installments of earnings and profits for the taxable year, a consent dividends credit equal to such portion of the total sum agreed to be included in the gross income of shareholders by their consent to partial liquidation distributions, as is the total amount of credits under this section which would have been permitted to be included in computing its basic surtax credit if it had distributed such total sum, as it would have been entitled to include in computing its basic surtax credit if actual distributions of such total sum had been made in each and such shareholder making such a consent had received, on the consent dividends day, the amount specified in the consent.

§ 29.28 (c) (1) Amount of consent dividends credit. The consent dividends credit forms part of the basic surtax credit (see section 27 (b) (1)). It consists of the amount which the corporation would be permitted to include in its basic surtax credit as a dividend paid if it had distributed such total sum, as it would have been entitled to include in computing its basic surtax credit if actual distributions of such total sum had been made in each and such shareholder making such a consent had received, on the consent dividends day, the amount specified in the consent.
sent shall be considered as a dividend received by him from sources within the United States; and

(6) Unless each consent filed is accompanied by cash, or such other medium of payment as the Commissioner may by regulations authorize, such consent shall be in the amount that would be required by sect. 143 (b) or 144 to be deducted and withheld by the corporation if the amount specified in the consent has been, on the last day of the taxable year of the corporation, paid to the shareholder in cash as a dividend. The amount accompanying the consent shall be credited against the tax imposed by section 211 (a) or 231 (a) upon the shareholder.

§ 29.28 (d)-1 Making and filing of consents. A consent shall be made in duplicate on oath or affirmation on Form 972 in accordance with the regulations and the instructions on the form or issued therewith and may be made only by or on behalf of a person who was the actual owner on the last day of the corporation's taxable year, of all or any part of such amount specified in consent stock, i.e., the person who would have been required to include in gross income any dividends on such stock actually distributed on the last day of such year. If the consent such person must agree:

(a) To include in his gross income for his taxable year in which or with which the taxable year of the corporation is included, the amount specified in the consent as a specific amount as a taxable dividend; and

(b) If he is a shareholder who is taxable with respect to a dividend only if received from sources within the United States, that the specific amount stated in his consent shall be considered as a dividend received by him from sources within the United States.

A consent may be made at any time not later than the due date of the corporation's income tax return for the taxable year for which the credit is claimed (see § 29.33-4) or such consent may be made as of any day not later than one year after October 21, 1942, if the corporation was a personal holding company for the taxable year for which the credit is claimed. When a consent is filed more than one year later than the due date thereof, or in the case of a personal holding company referred to in section 28 (d) (1), within one year after October 21, 1942, the corporation must file two duly executed duplicate originals of each consenting shareholder's consent, and a return on oath or affirmation on Form 973, or Form 973A, in the case of a personal holding company, showing by classifications of stock outstanding on the first and last days of the taxable year, the dividend rights of such stock, distribution made during the taxable year to shareholders, and giving all the other information required by the form.

In the event that any consent filed by the corporation is made by a shareholder in the payment of a dividend in cash, on the last day of the taxable year of the corporation, the corporation would have been required to deduct and withhold any amount as a tax under section 143 (b) or 144, such consent, when filed by the corporation, must be accompanied by payment of the amount which would have been required to be deducted and withheld if the amount specified in such consent had, on the last day of the corporation's taxable year, been paid to the shareholder in cash as a dividend. Such payment must be in one of the following forms:

(1) Cash;

(2) United States postal money order;

(3) Certified check drawn on a domestic bank, provided that the law of the place where the corporation is situated denies the right of the shareholder to reopen his consent for purposes of the partial distribution to be rescinded prior to presentation;

(4) A cashier's check of a domestic bank; or

(5) A draft on a domestic bank or a foreign bank maintaining a branch in the United States and payable in United States funds.

The amount of such payment shall be credited against the tax imposed by section 211 (a) or 231 (a) upon the shareholder.

§ 29.28 (d)-2 Consent distribution must be nonpreferential. The application of section 28 (d) (3) may be illustrated as follows:

Example. The X Corporation, which makes its income tax returns on the calendar year basis, has 200 shares of stock outstanding, including 100 shares owned by A and B in equal amounts. On December 16, 1942, the corporation distributes $500 to B and $100 to A. On December 31, 1942, A executes a consent distribution in a part or all of the consent stock owned by him. The X Corporation, assuming the other requirements of section 28 have been complied with, is entitled to a consent dividends credit of $500. Though considered by themselves as two separate distributions by section 702 and the consent distribution of $500 are preferential, when considered together they constitute a single nonpreferential distribution of $1,200.

§ 29.28 (d)-3 Overpayments and deficiencies. For the refund or credit of any overpayment, and the assessment or collection of any deficiency referred to in section 186 (h), see § 29.504-6.

§§ 29.28 (e)-1 Consent and partial distribution to be considered together.

The rule provided in section 28 (e), that a consent distribution and a partial distribution are to be considered as having been made in connection with each other and as together forming parts of one entire distribution, is not limited to the purposes of section 28, but is applicable in connection with any of the purposes of chapter 1. Thus, such rule is to be applied to determine if a partial distribution is a preferential dividend under section 27 (h). See § 29.27 (h)-1.

§§ 29.28 (e)-2 Taxability of amounts specified in consents. Once a shareholder's consent is filed, the full amount specified therein shall be included in his gross income as a dividend included in all the consents filed, had actual distribution been made, would have been in whole or in part a taxable dividend; and

(1) Whether he actually so includes it in his return; and

(2) Whether the distribution by the corporation of an amount equal to the total sum included in all the consents filed, had actual distribution been made, would have been in whole or in part a taxable dividend; and

(3) Whether the corporation is entitled to any consent dividends credit by reason of the filing of such consents, or to a credit less than the total sum included in all the consents filed.

§ 29.28 (f)-1 Taxability of amounts specified in consents. Once a shareholder's consent is filed, the full amount specified therein shall be included in his gross income as a dividend included in all the consents filed, had actual distribution been made, would have been in whole or in part a taxable dividend; and

(1) Whether he actually so includes it in his return; and

(2) Whether the distribution by the corporation of an amount equal to the total sum included in all the consents filed, had actual distribution been made, would have been in whole or in part a taxable dividend; and

(3) Whether the corporation is entitled to any consent dividends credit by reason of the filing of such consents, or to a credit less than the total sum included in all the consents filed.

The ground upon which a consent dividends credit is denied the corporation does not affect the taxability to a shareholder whose consent has been filed of the amount specified in his consent. Thus, if he is taxable on the full amount so filed, though a consent dividend credit is denied the corporation because (1) preferred dividends have not been paid, (2) part or all of the consent stock has been in a state of liquidation at any time during the taxable period, (3) the distribution of which the consent distribution is a part is preferential, (4) a consenting shareholder who is taxable with respect to a dividend only if received from sources within the United States fails to agree that the amount specified in his consent dividend credit should be included in gross income as a dividend received by him from sources within the United States, or (5) payment has not been made as required by section 28 (d) (5) and § 29.28 (d)-1.

§§ 28.28 (g)-1 Consent dividends credit—amended by sec. 186 (e), Rev. Act 1942. [See sec. 28, CONSENT DIVIDENDS CREDIT—amended by sec. 186 (e), Rev. Act 1942, for the purposes of this section, consent and partial distribution are considered to be made by the corporation under subsection (d) the consent distribution is a preferential dividend under section 27 (h). See § 29.27 (h)-1.]

§§ 28.28 (h)-1 Consent dividends credit—amended by sec. 186 (e), Rev. Act 1942. [See sec. 28, CONSENT DIVIDENDS CREDIT—amended by sec. 186 (e), Rev. Act 1942, for the purposes of this section, consent and partial distribution are considered to be made by the corporation under subsection (d) the consent distribution is a preferential dividend under section 27 (h). See § 29.27 (h)-1.]

Corporation shareholders.
shall be considered as part of its earnings or profits for the taxable year, and shall be included in the computation of its accumulated earnings and profits.

§ 29.28 (g) 1  Treatment of amount specified in consent of corporate shareholder. From the standpoint of computing a shareholder's income for a taxable year prior to the one to which he has agreed to include a specific amount in gross income, such amount is treated exactly as though such shareholder had received in cash a taxable dividend equal to the amount specified in his consent. Therefore, in the case of a corporate shareholder, such amount shall be included in the computation of its earnings and profits for the taxable year and its accumulated earnings and profits at the close of the taxable year. The effect of a corporate shareholder's consent upon the computation of its earnings and profits may be illustrated as follows:

Example. The X Corporation has one shareholder, A, who on December 31, 1941, consented to include $10,000 in its gross income for the calendar year 1942. The X Corporation, which has only one class of stock outstanding, has never made a distribution to shareholders, and, therefore, does not have any earnings or profits. The consent of A, is taxable on M6 as a dividend:

(a) The amount of the consent dividends credit is $400, being 80 percent of the amount specified in A's consent.

(b) Its basis surplus credit, assuming it has not net operations in the preceding year and no bank affiliate credit, is $630, consent stock's to be included in his gross assets at $50 and an allowance for dividends paid of $49.

(c) The amount of its accumulated earnings and profits at the beginning of such year is zero, because of the transfer of $49 (the amount of the consent dividends credit) from earnings and profits to capital account.

(d) Therefore, in the following year the X Corporation makes a distribution to shareholders, no part of such distribution will be a dividend, but it will all constitute a return of capital.

(a) In the case of A:

(i) A is taxable on $50 as a dividend.

(ii) The basis of his stock is increased by $50, his pro rata share of the total corporate earnings and profits.

(b) In the case of B:

(i) B is taxable on $49 as a dividend.

(ii) The basis of his stock is reduced by $50.

SEC. 29. CONSENT DIVIDENDS CREDIT—AS AMENDED BY SEC. 156 (a), REV. ACT 1942.

(b) Basis of stock in hands of shareholders. The amount specified in a consent made under subsection (d) shall, for the purpose of adjusting the basis of the consent stock with respect to which the consent was given, be treated as having been reinvested by the shareholder in the earnings and profits of the corporation; but only in an amount which bears the same ratio to the consent stock's capital and surplus as the amount of such shareholder's consent stock bears to the total amount of consent stock's with respect to which consents are made.

1. Effect on capital account of corporation. The amount of the consent dividends credit allowed under subsection (d) shall be considered as paid in surplus or as a contribution to the capital of the corporation, and the accumulated earnings and profits at the close of the taxable year shall be correspondingly reduced.

§ 29.28 (i)–1 Effect on basis of stock in hands of shareholders and capital account of corporation. The application of sections 29 (b) and 28 (i) may be illustrated by the following example:

Example. The X Corporation, which makes its income tax returns on the calendar year basis, has only one class of stock outstanding, owned entirely by A and B in equal amounts. A makes a consent to include $90 in his gross income as a dividend, but B refuses to do so. The X Corporation, therefore, distributes $90 to B in cash during the last month of its taxable year 1942. The consent is evidenced by a signed instrument delivered by A, and the actual distribution to B are treated together, as though one distribution of $30 had been made. The earnings and profits of the X Corporation for 1942, however, amount to only $50, there being at the beginning of such year no accumulated earnings and profits. If, therefore, $90 had actually been distributed, there would have been a dividend, includible in the X Corporation's basis surplus credit, and 20 percent thereof, or $18, would have constituted a return of capital. The consent of A, therefore, reduces the total amount of capital by $18, and the basis of A's consent stock is reduced by $18, the consent dividends credit is $72, and an allowance for dividends paid of $49.

Remediation against excess.

(1) The amount of the consent dividends credit is $400, being 80 percent of the amount specified in A's consent.

(2) Its basis surplus credit, assuming it has not net operations in the preceding year and no bank affiliate credit, is $630, consent stock's to be included in his gross assets at $50 and an allowance for dividends paid of $49.

(3) The amount of its accumulated earnings and profits at the beginning of such year is zero, because of the transfer of $49 (the amount of the consent dividends credit) from earnings and profits to capital account.

Treatment of amount included in shareholders' income. Amounts not included in shareholders' income, war-profits, and deductions as of the end of the taxable year shall be included in the computation of its accumulated earnings and profits for the taxable year, and shall be included as a return of capital to the extent of the part thereof which bears the same ratio to the amount specified in the consent as though such shareholder had received such amount as a contribution to the shareholders' capital. The consent dividends credit of the corporation shall be reduced as to the extent of the part thereof which bears the same ratio to the amount specified in the consent as though such shareholder had received such amount as a contribution to the shareholders' capital.

Amount specified in the case of a non-corporate shareholder. Any agreement to include any amount in gross income other than a dividend or credits against the tax for the taxable year in which the agreement is entered into, shall be treated as if it were an agreement to include in gross income for the taxable year the amount specified in the agreement by such shareholder, and to include a specific amount in gross income for such taxable year. Any such agreement shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. The income, items of income, and deductions which are included in the computation of its accumulated earnings and profits and its basis surplus credit shall be treated as if the amount specified in the agreement were included in the computation of its gross income for such taxable year. The income, items of income, and deductions which are included in the computation of its accumulated earnings and profits shall be treated as if the amount specified in the agreement were included in the computation of its gross income for such taxable year. If the aggregate of the consent dividends credit and the basis surplus credit of a corporation for the taxable year is less than the amount of the consent dividends credit and the basis surplus credit specified in the consent, the excess shall be included in the computation of its accumulated earnings and profits and its basis surplus credit for the taxable year. If the aggregate of the consent dividends credit and the basis surplus credit of a corporation for the taxable year is greater than the amount of the consent dividends credit and the basis surplus credit specified in the consent, the excess shall be treated as a return of capital to the extent of the part thereof which bears the same ratio to the amount specified in the consent as though such shareholder had received such amount as a contribution to the shareholders' capital.

Amounts not included in shareholders' income. Amounts not included in shareholders' income, war-profits, and deductions as of the end of the taxable year shall be included in the computation of its accumulated earnings and profits for the taxable year, and shall be included as a return of capital to the extent of the part thereof which bears the same ratio to the amount specified in the consent as though such shareholder had received such amount as a contribution to the shareholders' capital.

Amounts included in the computation of its accumulated earnings and profits shall be treated as if they were included in the computation of its gross income for the taxable year, and shall be included as a return of capital to the extent of the part thereof which bears the same ratio to the amount specified in the consent as though such shareholder had received such amount as a contribution to the shareholders' capital.
taxable year and for the preceding year.

On the other hand, appreciation in value of gross income which has been purchased and sales will correctly reflect income except as provided in § 29.44-1, but are applicable if a taxpayer desires to change from such appreciation to a straight accrual basis. In case where permission to make such change is granted, the taxpayer will be required to use the true income for the taxable year in which the change is made and all the profit not then realized will be treated as income on the payments due on installment sales contracts as of the close of the preceding taxable year.

§ 29.41-3. 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 choose the method best suited to his purpose. Each taxpayer is required by law to make a return of his true income. He must, therefore, keep accurate and distinct records as will enable him to do so. (See section 54 and § 29.54-1.) Among the essentials are the following:

(a) In all cases in which the production, purchase, or sale of merchandise or other property is an income-producing factor, any taxable year beginning after December 31, 1940, treat such increase as income received in such taxable year. If any such change is made during the fiscal year of a State or Territory, or any political subdivision thereof, or a different period, in the case of the death of a taxpayer whose net income is computed upon the basis of the fiscal year to which his election applies, the new method of accounting followed thereafter, unless properly applied, will be included in computing the net income for the period in which falls the taxable year. (For application of subsection (c) to fiscal years beginning before January 1, 1943, see § 20.42-1 (b).)

(b) In computing net income, the interest-bearing obligations issued at a discount and redeemable for stated amounts increasing at a stated rate of interest. In the case of the death of a taxpayer whose net income is computed upon the basis of any such obligations owned by him, the increase in the redemption price of such obligations occurring in the taxable year to which his election applies, to all such obligations owned by the taxpayer at the beginning of the fiscal year to which such election applies and to all such obligations owned by him in any subsequent taxable year to which his election applies and to all such obligations owned by him in any subsequent taxable year to which such election applies.

(c) In case of any obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 4, 1941, on a discount basis and payable without interest, any principal sum paid at maturity, sold, or otherwise disposed of.

§ 29.42-1 When included in gross income. (a) In general. Except as otherwise provided in section 42, 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 as of a different period in accordance with the approved method of accounting followed by him. (See §§ 29.41-1 to 29.41-3, inclusive.) (As amended by section 155, Revenue Act of 1926).
to income from noninterest-bearing obligations issued at discount, see § 29.42-6, and as to income from short-term obligations issued on a discount basis, see § 29.42-7. If no determination of compensation is had until the completion of the services, the amount received is ordinarily income for the taxable year of its determination, if the return is rendered on the accrual basis; or for the taxable year in which received, if the return is rendered on the receipts and disbursements basis. If a person sues in one year and is déceased partner out of such fees will be income to such estate or person. There must also be included in computing net income for the taxable year in which falls the date of death of a taxpayer the gain described in section 42 (g), relating to gain upon the disposition of installment obligations, except as otherwise provided in that section. See § 29.42-5. If death must be had in computing net income regardless of the method of accounting followed by the taxpayer.

Section 134 (a) of the Revenue Act of 1942 changed the last sentence of section 42 (a) of the Internal Revenue Code to its present form, as set forth above. Prior to such change, the last sentence of section 42 (a) provided as follows:

In the case of the death of a taxpayer there shall be included in the net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death and thereafter deducted by him in determining and accounting for his income for the taxable period or a prior period.

Section 134 (f) of the Revenue Act of 1942 provides that the change in the last sentence of section 42 (a) shall be applicable taxable years beginning after December 31, 1942. Section 134 (g) of the Revenue Act of 1942 provides that such change shall be applicable to taxable years beginning before January 1, 1943, if the executor, administrator, or other personal representative of the taxpayer and the persons who acquire his property as beneficiaries of his estate or by reason of his death shall have elected to and did so elect to have the provisions of section 42 (a) applicable to taxable years beginning after December 31, 1942. See § 29.42-5 (g) to have the amendments made by section 134 (f) and (g) apply to the law in effect for such taxable years. Accordingly, if the taxable year in which falls the death of a taxpayer begins before January 1, 1943, the provisions of the first paragraph of this section (b) are applicable only if such election has been made. See § 29.42-4, relating to such election and to the method of computing, and limitations with respect to, credit or refund of any overpayment which is a result of such change. If such election is not made, then there shall be included in computing net income for such taxable year, in addition to the amounts described in paragraph (a) of this section, all amounts accrued up to the date of the taxpayer's death which are not otherwise properly includible in respect of such taxable year or a prior taxable year, regardless of the fact that the decedent may have kept his books and made his return on the basis of cash receipts and disbursements.

\[ \text{Section 134 (f) of the Revenue Act of 1942 provides that the change in the last sentence of section 42 (a) shall be applicable taxable years beginning after December 31, 1942. Section 134 (g) of the Revenue Act of 1942 provides that such change shall be applicable to taxable years beginning before January 1, 1943, if the executor, administrator, or other personal representative of the taxpayer and the persons who acquire his property as beneficiaries of his estate or by reason of his death shall have elected to and did so elect to have the provisions of section 42 (a) applicable to taxable years beginning after December 31, 1942. See § 29.42-5 (g) to have the amendments made by section 134 (f) and (g) apply to the law in effect for such taxable years. Accordingly, if the taxable year in which falls the death of a taxpayer begins before January 1, 1943, the provisions of the first paragraph of this section (b) are applicable only if such election has been made. See § 29.42-4, relating to such election and to the method of computing, and limitations with respect to, credit or refund of any overpayment which is a result of such change. If such election is not made, then there shall be included in computing net income for such taxable year, in addition to the amounts described in paragraph (a) of this section, all amounts accrued up to the date of the taxpayer's death which are not otherwise properly includible in respect of such taxable year or a prior taxable year, regardless of the fact that the decedent may have kept his books and made his return on the basis of cash receipts and disbursements.} \]
prepare their returns upon either of the following bases:

(a) Gross income derived from such contracts must be reported upon the basis of percentage of completion. In such case there should accompany the return certificates of architects or engineers showing the percentage of completion during the taxable year of the entire work to be performed under the contract. There should be deducted from such gross income all expenditures made during the taxable year on account of the contract, account being taken of the material and supplies charged to the work under the contract but remaining on hand at the beginning and end of the taxable period for use in connection with the work under the contract but not yet so applied.

(b) Gross income may be reported for the taxable year in which the contract is finally completed and accepted if the taxpayer elects as a consistent practice so to treat such income, provided such method closely reflects the net income. If this method is adopted there should be deducted from gross income all expenditures during the life of the contract which are properly allocated to labor and materials utilized therein. This method of accounting used in computing his net income, the taxpayer may, at his election, treat such increase as constituting income for the year in which the obligation is disposed of, redeemed, or paid at maturity. The election must be made in the taxpayer's return, and may be made for any taxable year. The election shall apply also to all other obligations of the type described in this section owned by the taxpayer at the beginning of the first taxable year to which the election applies and to those thereafter acquired. It shall apply to the taxable year for which such return is filed, and shall be binding for all subsequent taxable years unless upon application by the taxpayer the Commissioner permits the taxpayer, subject to such conditions as the Commissioner deems necessary, to change to a different method of reporting income from such obligations. Although the election, once made, is binding under the taxpayer, it does not apply to a transferee of such taxpayer.

In any case in which an election is made under this section, the amount considered to accrue in any taxable year to which the election applies is measured by the actual increases in the redemption price occurring in that year. Such amount shall not be considered to accrue ratably between the dates on which the redemption price changes. Thus, if two dates on which the redemption price increases fall within a taxable year and if the redemption price at the second date is in the amount of 50 cents on each such date, the amount deemed to accrue in that year would be $1. If at the beginning of the first taxable year to which the election applies the taxpayer holds non-interest-bearing bonds of the prescribed character acquired prior thereto, he is required to report in such year, in addition to the increases in the redemption price actually falling within that year, the total of the increases in such price occurring between the date of his acquisition and the beginning of such year.

Example. Throughout the calendar year 1945, a taxpayer who makes his income tax returns on the calendar year basis and computes his net income on the cash receipts and disbursements basis holds the following United States bonds:

(a) United States savings bonds having a maturity value of $10,000, which he purchased on January 1, 1941, for $7,500. The entire increase in the redemption price of these bonds is exempt from both the normal tax and the surtax.

(b) United States Defense savings bonds, Series A, face value of $500, which he purchased on January 1, 1942, for $3,750. The increase in the redemption price of these bonds is subject to both the normal tax and the surtax.

§ 29.42-6 Noninterest bearing obligations issued at discount. If a taxpayer owns any noninterest-bearing obligations of the prescribed character described in this section, see § 29.117-1.

In the case of the United States savings bonds acquired on January 1, 1938, the increases of $400 and $100 in the redemption price are attributable to the principal amount (purchase price) in excess of $5,000.

§ 29.42-7 Short-term obligations issued on discount basis. In the case of any obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, at a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, the increase of the discount at which such obligation is originally sold shall not be considered to accrue until the date on which such obligation is paid at maturity, sold, or otherwise disposed of. Accrual of such discount, if a taxpayer who computes his net income on the accrual basis purchases upon issuance a United States Treasury bill issued on or after March 1, 1941, and holds it until maturity, the entire amount of the discount at which the bill was originally sold accrues on the date of maturity; and if such a taxpayer holds a United States Treasury bill issued on or after March 1, 1941, for a period less than its life, the portion of the original discount attributable to such period accrues only on the date on which he sells or otherwise disposes of the bill or receives payment at maturity. The original discount or the portion of such discount, as the case may be, is includible only in the gross income for the taxable year in which the taxpayer sells or otherwise disposes of the bill or receives payment at maturity. For examples illustrating rules for computation of income from sale of short-term obligations of the type described in this section, see § 29.117-1.
SEC. 43. Period for which deductions and credits taken [as amended by sec. 184 (b), Rev. Act 1942].

The deductions and credits (other than the corporation division or paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred" proportionately in any subsequent taxable year depends upon the method of accounting upon the basis of which the net income is computed. Where the taxpayer clearly reflects the income the deductions or credits should be taken as of a different period. In the case of the death of a taxpayer whose net income is computed upon the basis of the "taxable year from sources without the United States," section 134 (b) of the Revenue Act of 1943 changed the rule of section 43 of the Internal Revenue Code to its present form, as set forth above.

Prior to such change, the last sentence of section 43 read as follows:

"In the case of the death of a taxpayer there shall be allowed as deductions and credits for the taxable period in which falls the date of his death, amounts accrued up to the date of his death under section 23 (c) if not otherwise properly allowable in respect of such period or a prior period."

Section 134 (b) of the Revenue Act of 1943 provided that the change in the last sentence of section 43 shall be applicable to taxable years beginning after December 31, 1942. Section 134 (g) of the Revenue Act of 1943 provides that such change shall be applicable to taxable years beginning before January 1, 1943, if the executor, the administrator, or other personal representative of the taxpayer and the persons who acquire as beneficiaries of his estate or by reason of his death his right to receive any income make the election provided in such section 134 (g) (see § 29.126-4) to have the amendments made by section 134 apply to him in respect of such taxable years.

Accordingly, if the taxable year in which falls the date of the death of a taxpayer begins before January 1, 1943, the provisions of the first paragraph of this section 43 shall be applicable only if such election has been made. See § 29.126-4, relating to such election and to the method of computing, and limitations with respect to, credit or refund of any overpayment of such election. If such election is not made, then there shall also be allowed as deductions and credits for such taxable year, in addition to the amounts determined in this section and all amounts (except deductions under section 23 (c)) accrued up to the date of the taxpayer's death which are not otherwise allowable with respect to such taxable year or a prior taxable year, regardless of the fact that the decedent may have been required to keep his books and make his return on the basis of cash receipts and disbursements.

SEC. 44. INSTALLMENT BASIS.

(a) Dealers in personal property. Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan, and who receives or expects to receive substantial payments of the total amount due during a taxable year, that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed bears to the total contract price.

(b) Sales of real and chattel sales of personal property. In the case of a real estate or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 30 per centum of the selling price (or, in case the sale or other disposition was in a taxable year beginning prior to January 1, 1934, the percentage of the contract price prescribed in the law applicable to such year), the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned to the basis and the gain or loss upon the sale or other disposition prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidence of a debt except for any purchase money mortgage given by the buyer during the taxable period in which the sale or other disposition is made.

1So in original.
(c) Change from accrual to installment basis. If a taxpayer entitled to the benefits of subsection (a) elects for any taxable year to report his net income on the installment basis, then in computing his income for the year of change or any subsequent year, installment payments actually received in that year which the total or gross profit (that is, sales less cost of goods sold) realized or to be realized when the property is sold or disposed of, or the total contracted for or the total sale price, whichever is the smaller, exceeds 50 percent of the total contract price of all such sales made during that respective year. No payments received in the taxable year shall be excluded in computing the amount of income to be reported on the installment basis of returning income. But if the case of any taxpayer who, by an original return made prior to February 26, 1943, changed the method of reporting his net income for any taxable year that proportion of the total payments (such payments being allocated to the year against the sales of which they apply) which the total or gross profit realized or to be realized on the installment contract during the year bears to the total contract price of all such sales made during that respective year.

§ 29.44-4 Sale of real property involving deferred payments. Under section 44 deferred-payment sales of real property include (a) agreements of purchase and sale in which the consideration is to be made at the outset, (b) agreements of purchase and sale in which the consideration is to be made at the outset, (c) agreements of purchase and sale in which the consideration is to be made at the outset.

§ 29.44-4 Sale of personal property on installment plan. Dealer's personal property ordinarily sell either for cash or on installment basis. The general rule prescribed is that a person who regularly sells or otherwise disposes of personal property on the installment basis, whether or not title remains in the vendor until the purchaser has performed his part of the transaction;

(a) By a form of contract in which title is conveyed to the buyer immediately, but subject to a lien for the unpaid portion of the selling price;

(b) By a present transfer of title to the purchaser, the amount of which is subject to a charge upon the repossession or sale of the property repossessed or the purchase price thereof in the absence of clear and convincing proof to the contrary. The property repossessed shall be carried on the books of the vendor at the fair market value at the time of repossession.

If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such a course is permissible.
vendor in the year of sale from the dis-
position to a third person of notes given by
the vendee as part of the purchase price which
are due and payable in subsequent years.
Commissions and other selling expenses
are not to be deducted or taken into account
in determining the amount of the "initial pay-
ments," the "total contract price," or the "selling
price." The term "initial payments" contemplates
at least one other payment in addition to
the initial payment. If the entire purchase price is to be paid in a lump sum in a later year, there being no pay-
ments due or to be realized during the year, the instal-
ment payments may not be returned on the installment
basis. Income may not be returned on the installment basis where no payment in cash or property, other than evidences
of indebtedness of the purchaser, is re-
ceived during the first year, the pur-
chaser having promised to make two or
more payments in later years.

§ 29.44-4 Deferred-payment sale of real property not on installment plan. In transac-
tions included in class (2) in § 29.44-3, the obligations of the pur-
chaser received by the vendor are to be
considered as due and payable in cash from
the amount of the fund realized on the property
paid for by the vendor or the vendee.

If the property reacquired is sold in any of his payments, and the vendor re-
possesses the property, the difference be-
tween (a) the entire amount of the pay-
ments actually realized on the contract
and retained by the vendor plus the fair
market value at the time of repossession
of fixed improvements placed on the
property by the vendor and (b) the sum
of the profits previously returned as
income in connection therewith and
an amount representing what would
have been a proper adjustment for ex-
haustion, wear and tear, obsolescence,
amortization, improvements placed on
the property during the period the prop-
erty was in the hands of the vendor had the
sale not been made will constitute gain
or loss, as the case may be, to the vendor
for the year in which the property is
repossessed, and the basis of the property
in the hands of the vendor will be the
original basis at the time of the sale
plus the fair market value at that time
of repossession or fixed improvements
placed on the property by the purchaser.

If the vendor has previously transferred title to the property or the purchaser has
sold the property, the vendor re-
possesses the property in full. The loss,
if ascertained to be worthless and
carried forward as a bad debt,
charged off within the taxable year, ex-
ccept that if the obligations satisfied are
due in the year of sale from the dis-
position to a third person of notes given
by the vendee as part of the purchase
price which are due and payable in sub-
csequent years. Commissions and other
selling expenses are not to be deducted or
taken into account in determining the amount
of the "initial payments," the "total
contract price," or the "selling price." The
word "initial payments" contemplates
at least one other payment in addition to
the initial payment. If the entire purchase price is to be paid in a lump sum in a later year, there being no pay-
ments due or to be realized during the year, the instal-
ment payments may not be returned on the installment
basis. Income may not be returned on the installment basis where no payment in cash or property, other than evidences
of indebtedness of the purchaser, is re-
ceived during the first year, the pur-
chaser having promised to make two or
more payments in later years.

§ 29.44-5 Gain or loss on disposition of installment obligations. The entire amount
of gain or loss resulting from the dis-
position of such obligations, computed in accordance
with section 44 (d), is recognized under the Internal Revenue Code unless the disposition is within one of the ex-
ceptions made by the Code. Such an
exception is provided in section 44 (d) with respect
to distributions under section 112 (b) (4), and in section 112 (b) (4) and (5) with respect to exchanges.

The application of section 44 (d) may be
illustrated by the following examples:

Example (1). In 1940 the M Corporation
sold a piece of underdeveloped real estate to B
for $30,000. The company acquired the prop-
erty in 1930 at a cost of $20,000. In 1940 the company received $5,000 cash and vendor's notes for the remainder of the selling price, or $25,000, payable in ten equal annual payments.
In 1942, before the vendor made any further payments, the company sold the notes for $15,000 in cash. The corporation makes its returns on the calendar year basis. The in-
come to be reported for 1942 is $5,500, com-
pared as follows:

| Proceeds of sales of notes | $15,000 |
| Cost of property sold | $20,000 |
| Total profit | $5,500 |
| Total contract price | $25,000 |
| Percent of profit, or propor-
tion of each payment return-
able as income | 22 percent |
| Face value of notes | $6,000 |
| Amount of income return-
able | $1,320 |
| Excess of face value of notes over amount of income return-
able | $4,680 |
| Taxable income to be reported for 1942 | $5,500 |
Example (2). Suppose in the example given above, instead of selling the notes, distributed them in 1942 to its shareholders as a dividend, and at the time of such distribution the fair market value of the notes was $14,000. The income to be reported for 1942 is $6,500, computed as follows:

Fair market value of notes........... $14,000
Excess of the face value or other amount of income returnable were the notes satisfied in full (computed as in example (1))................. 7,500

Taxable income to be reported for 1942........................................ 6,500

If the taxpayer, referred to in the above examples (1) and (2) as Corporation M, had been held for the income to be reported, shown above as $5,500 and $6,500, respectively, would have been limited to 50 percent thereof by section 117 (c), the real estate having been held for tax purposes and disposed of in 1940. See also section 117 (o).

In the case of a decedent who died possessed of installment obligations, no gain on appreciation of the amount of such obligations is required to be reported as income in the return of the decedent for the year of his death, if the executor or administrator of the estate of the decedent or any of the decedent's kin or legatees files with the Commissioner a bond on Form 1132 conditioned upon the return as income, by any person reporting any payment in satisfaction of such obligations, of the same proportion of such payment as would be returnable as income by the decedent if he had lived and received such payments. The bond shall be subject to the approval of the Commissioner, and shall be in an amount sufficient in his judgment to insure collection of the tax resulting from the fulfillment of the conditions stated in the bond, and shall be filed at the time of filing the return for the decedent for the year of his death or at such later time as may be specified by the Commissioner. A corporation will not be treated as a surety on a surety bond unless the corporation holds a certificate of authority from the Secretary as an acceptable surety on Federal bonds. In lieu of surety or sureties there may be deposited bonds or notes of the United States.

See section 117 as to the limitation on capital losses sustained by corporations and the limitation as to both capital gains and capital losses of individuals.

Sec. 45. Allocation of income and deductions.

In any case of two or more organizations, trades, or businesses (whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income or deductions between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations or businesses.

§ 945-1 Determination of the taxable net income of a controlled taxpayer—

(a) Definitions. When used in this section:

(1) The term "organization" includes any organization of any kind, whether or not its form or mode of its exercise is legally enforceable, and however exercisable or exercised. It is the reality of that control which is decisive, whether or not its form or mode of its exercise is legally enforceable, and however exercisable or exercised. To determine the true net income of a controlled taxpayer, it is necessary of gross income or deductions, or of any item or element affecting net income, between or among the controlled taxpayers qualifying as the group, to determine the true net income of each controlled taxpayer. The standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.

Section 45 and this section apply to the case of any controlled taxpayer, whether such taxpayer makes a separate or a consolidated return. If a controlled taxpayer makes a separate return, the determination is of its true separate net income. If a controlled taxpayer is a party to a consolidated return, the true consolidated net income of the affiliated group and the true separate net income of the controlled taxpayer are determined consistently with the principles of a case of a device designed to reduce or avoid tax by shifting or distorting income or deductions. In determining the true net income of a controlled taxpayer, the Commissioner is not restricted to the case of improper accounting, to the case of a fraudulent, colorable, or sham transaction, or to the case of a device designed to reduce or avoid tax by shifting or distorting income or deductions. The authority to determine true net income extends to any case in which either by inadvertent design or in whole or in part, of a controlled taxpayer, is other than it would have been had the taxpayer in the conduct of his affairs been an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.

(b) Scope and purpose. The purpose of section 48 is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true net income from the property and business of a controlled taxpayer. The Commissioner, exercising the powers of section 45, is to determine whether a group of controlled taxpayers are assumed to have complete power to cause each controlled taxpayer so to conduct its affairs that its transactions and acquisitions of income or deduction in respect of income from the property and business of each of the controlled taxpayers. If, however, this has not been done, and the taxable net incomes are thereby understated, the statute contemplates that the Commissioner shall intervene, and by making such distributions, apportionments, or allocations as he may deem necessary of gross income or deductions, or of any item or element affecting net income, between or among the controlled taxpayers constituting the group, shall determine the true net income of each controlled taxpayer. The standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.

Section 45 grants no right to a controlled taxpayer to apply its provisions at will, nor does it grant any right to compel the Commissioner to apply such provisions. In the case of the computation of consolidated net income under a consolidated return to effect in any case such a distribution, apportionment, or allocation of gross income or deductions, or any item of either, as would produce a result equivalent to a computation of consolidated net income under section 141.

(c) Application. Transactions between one controlled taxpayer and another will be subjected to special scrutiny to ascertain whether the common control is being used to reduce, avoid, or escape taxes. In determining the true net income of a controlled taxpayer, the Commissioner is not restricted to the case of improper accounting, to the case of a fraudulent, colorable, or sham transaction, or to the case of a device designed to reduce or avoid tax by shifting or distorting income or deductions. The authority to determine true net income extends to any case in which either by inadvertent design or in whole or in part, of a controlled taxpayer, is other than it would have been had the taxpayer in the conduct of his affairs been an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.

Sec. 46. Change of accounting period.

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 47.

§ 29.46-1 Change of accounting period. If a taxpayer (other than a subsidiary corporation required to change its accounting period by reason of the provisions of section 46) changes its accounting period he shall, prior to the expiration of 30 days from the close of the fractional part of the year for which a return would be required to effect the change, furnish to the collector, for transmission to the Commissioner, the information required on Form 1128. However, if the fractional
part of the year for which a return would be required to effect the change ends after July 1, such taxpayer shall, before using the new period for income tax purposes, secure the consent of the Commissioner, and application for permission to change the accounting period shall be made in accordance with the Instructions printed on Form 1128 at least 60 days prior to the close of the fractional part of the year for which a return would be required to effect the change. If a change of accounting period is made, a return is required for income tax purposes under § 23.14 of this chapter or for excess profits tax purposes under § 33.14 of this chapter. The information required on Form 1128 shall be furnished by the subscriber at or before the time of filing the consolidated income tax return or the consolidated excess profits tax return, as the case may be. For the due date of returns for fractional parts of a year see § 29.53-1. If the change is approved by the Commissioner, the taxpayer shall thereafter make his returns and compute his income upon the basis of the new accounting period. (See section 47.)

SEC. 47. Returns for a period of less than twelve months [as amended by sec. 136 (a) Rev. Act 1942].

(c) Returns for short period resulting from change of accounting period. 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 fiscal year for which the return was made and the following December 31. If the change is from calendar year to fiscal year, a 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.

(d) Income computed on basis of short period. A return is made under subsection (a) on account of a change in the accounting period, and in all other cases, where a separate return is required or permitted by this section, by the taxpayer with the approval of the Commissioner with the approval of the Secretary, to be made for a fractional part of a year, the income bears to 12 months of the period for which separate return is made.

(e) Income placed on annual basis—(1) General rule. If a separate return is made under subsection (a) on account of a change in the accounting period, the net income, computed on the basis of the period for which separate return is made (referred to in this subsection as "the short period"), shall be placed on an annual basis by multiplying the amount thereof by twelve, and dividing by the number of months in the short period. The tax due on such part of the tax computed on such short period as the number of months in the short period is of twelve months.

(2) Exception. If the taxpayer establishes the amount of his net income for the period of twelve months beginning with the first day of the first month of such twelve-month period were a taxable year, under the law applicable to such year, then the tax for the short period shall be reduced to an amount representing the portion of the tax computed on the net income for such twelve-month period as the net income computed on the basis of the short period is of the net income for the twelve-month period. The taxpayer (other than a taxpayer to which the provisions of subparagraph (a) do not apply) shall compute the tax and file his return without the application of this paragraph. If the taxpayer (other than a corporation) is subject to the excise tax of the end of the twelve-month period, or if the taxpayer is a corporation and has disposed of substantially all its assets prior to the close of such twelve-month period, then in lieu of the net income for such twelve-month period there shall be used for the purposes of this paragraph the net income for the twelve-month period ending with the last day of the short period. The tax computed under this paragraph shall be less than the tax computed on the net income for the short period without placing such net income on an annual basis. The benefits of this paragraph shall not be allowed unless the taxpayer, at such time or on regulations prescribed hereunder require (but not after the time prescribed for return under subparagraph (a) on account of a change in accounting period), section 711, may deem necessary for the application of this paragraph.

(d) Earned income. The Commissioner with the approval of the Secretary shall by regulations prescribe the method of applying the provisions of subsections (b) and (c) (relating to computing income on the basis of a short period, and placing such income on an annual basis) to the income of the corporation for the period for which the return is made, for the first taxable year which ends on or after twelve months after the beginning of the short period, makes application therefor in accordance with such regulations. Such application, in cases where returns were filed without regulations prescribed, shall be considered a failure for credit or refund with respect to the amount by which the tax is reduced under this paragraph. The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary for the application of this paragraph.

(e) Reduction of credit against net income. In the case of a return for a fractional part of a year, except a return made under subsection (a), on account of a change in the accounting period, the personal exemption and credit for dependents shall be reduced respectively to amounts which are the same as the credits provided as the number of months in the period for which the return is made bears to twelve months.

(f) Closing of taxable year in case of insolvency. For closing of taxable year in case of insolvency, see section 160.

(g) Returns where taxpayer not in existence for twelve months. In the case of a taxpayer not in existence during the whole of an annual accounting period ending on the last day of a month, or if, the taxpayer has no such annual accounting period or does not keep books for a period of a calendar year, the return shall be made for the fractional part of the year during which the taxpayer was in existence.

§ 29.47-1 Returns for periods of less than 12 months. No return can be made for a period of more than 12 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 a period of less than 12 months to another taxable year. The periods to be covered by such separate returns in the several cases are stated in section 47 (a). The requirements with respect to the net income from the short period 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, except as otherwise provided in § 29.55-1 and § 29.55-1 (a). (See sections 33 and 35.) If a return is made for a fractional part of a year, the income from the short period is placed on an annual basis by multiplying the amount thereof by 12 and dividing by the number of months in the short period. The tax is such part of the tax computed on such annual basis as the number of months in the period is of 12 months.

In placing on an annual basis the net income of a corporation for a short period, the credit for dividends received is placed on an annual basis by multiplying the amount thereof by 12 and dividing by the number of months in the short period. The tax is such part of the tax computed on such annual basis as the number of months in the period is of 12 months.

Similarly, the credit for interest on United States obligations should reflect the amount of such interest as increased when such amount is placed on an annual basis as part of the net income which is placed on an annual basis. If the corporation computes its excess profits tax under section 26 (e) for the income of the corporation subject to excess profits tax is considered an amount of which the excess profits tax of the corporation for such period is 90 percent. For the computation of such credit in case the net income of the corporation is placed on an annual basis, see § 29.47-2.

The tax of a decedent for the taxable year in which falls the date of his death is a return for the period during which he was alive.

§ 29.47-2 Returns for period of less than 12 months on account of a change in accounting period. A return is made when the corporation is placed on an annual basis in case of insolvency. A return is placed on an annual basis and tax computed thereon. In the case of a return for a period of less than 12 months on account of a change in accounting period, section 711 (f) provides that the net income computed and the credit provided in section 26 (e) for the income of the corporation subject to excess profits tax is considered an amount of which the excess profits tax of the corporation for such period is 90 percent. For the computation of such credit in case the net income of the corporation is placed on an annual basis, see § 29.47-2.
Interest on United States obligations subject to credit provided in section 29 (a) $4,000
Multiplied by 12  $48,000
Subtracting: Credit provided in section 29 (b) $12,000
Net interest on annual basis ($48,000 - $12,000) $36,000
Normal tax net income $59,325
Surplus net income $41,325

Total tax on annual basis $24,690
Amount of tax for period ($48,000 X .05) $24,000

If it had been assumed that the corporation had applied for the benefits of section 711 (a) (3) (A), and that the excess profits tax for the short period had been $18,750, then in the above example the excess profits net income of the corporation, computed for the tax year ended September 30, 1942, on account of the 3-month period, would be $27,375, the amount upon which the corporation was entitled to the application of section 711 (a) (3) (A), but would be $11,250, the adjusted excess profits net income of the corporation, applied against the $108,000 net income (as adjusted excess profits net income of the corporation, applied against the $108,000 net income (as placed on an annual basis), would be $27,375, the amount upon which the application of section 711 (a) (3) (A), but would be $11,250, the adjusted excess profits net income of the corporation, applied against the $108,000 net income (as placed on an annual basis). The computation would be as follows:

Excess profits for short period $11,250
Adjusted excess profits net income for short period (amount of excess profits net income of the corporation, computed for the tax year ended September 30, 1942, on account of the 3-month period, would be $27,375, the amount upon which the application of section 711 (a) (3) (A), but would be $11,250, the adjusted excess profits net income of the corporation, applied against the $108,000 net income (as placed on an annual basis), would be $27,375, the amount upon which the application of section 711 (a) (3) (A), but would be $11,250, the adjusted excess profits net income of the corporation, applied against the $108,000 net income (as placed on an annual basis)).

Normal tax net income $59,325
Surplus net income $41,325

Total tax on annual basis $24,690
Amount of tax for period ($48,000 X .01) $48,000

If any other item partially applicable to such 12-month period has been apportioned to the 3-month period to which it relates under paragraph (c), it shall be subject to the excess profits tax for such taxable year at the rate of 50% of the amount of such item which relates to such 3-month period and which is allocable to the period beginning with the first day of such 3-month period and ending with the last day of such 3-month period. If a corporation ceases business and distributes so much of the assets used in its business that it cannot resume its customary operations with the remaining assets, it will be considered to have distributed substantially all of its assets.

In computing the tax under section 47 (c) (2), the net income for the short period is not placed on an annual basis.

The net income for the 12-month period is computed under the same provisions of law as are applicable to the short period, and is computed as if the 12-month period were an actual accounting period of the taxpayer, which fall in such 12-month period must be included even if they are extraordinary in amount or of an unusual nature. If the taxpayer is a member of a partnership, there shall be included in computing his income for the 12-month period his share of the partnership income for taxable years of the partnership ending during such 12-month period, but no amount shall be included with respect to a taxable year of the partnership ending after such 12-month period. In the case of a corporation, the credit provided by section 29 (a) for the adjusted excess profits net income of the corporation is computed as an amount of which the excess profits tax imposed for such 12-month period is 50% of the amount of the excess profits net income of the corporation, computed for the 12-month period which includes only part of such 12-month period, such part of the excess profits tax for such taxable year, attributable to the excess profits tax on the excess profits net income of the corporation, computed for the 12-month period included in such taxable year, shall be used. If any other item partially applicable to such 12-month period has been apportioned to the 3-month period to which it relates under paragraph (c), it shall be subject to the excess profits tax for such taxable year at the rate of 50% of the amount of such item which relates to such 3-month period and which is allocable to the period beginning with the first day of such 3-month period and ending with the last day of such 3-month period. If a corporation ceases business and distributes so much of the assets used in its business that it cannot resume its customary operations with the remaining assets, it will be considered to have distributed substantially all of its assets.

In computing the tax under section 47 (c) (2), the net income for the short period is not placed on an annual basis.
1943, as the gross receipts from sales for such 3-month period are of the gross receipts from sales for the entire fiscal year. The Commissioner may, in granting permission to a taxpayer to change its accounting period, require as a condition to granting the change that, if the taxpayer is to obtain the benefits of section 47 (c) (2), it shall take a closing inventory upon the last day of the 12-month period. Such closing inventory will be necessary for the purpose of section 47 (c) (2), and the taxpayer will not be required to use such inventory in computing the net income for the taxable year in which such inventory is taken.

The tax for the short period may not be reduced under section 47 (c) (2) to an amount which is less than the tax for the short period computed on the basis of the net income for the short period without placing such net income on an annual basis. If the tax computed under section 47 (c) (2) by reference to the net income for the 12-month period is less than such amount, the tax may be reduced only to such amount. In computing the tax of a corporation for the short period without placing its net income on an annual basis, the adjusted excess profits tax for the purpose of determining the credit under section 26 (e), an amount, of which the excess profits tax of the corporation for the short period is 90 percent.

The following examples illustrate the application of section 47 (c) (2):

Example (1). The facts are the same as in example (1) in paragraph (a) of this section. In the period from January 1, 1942, to December 31, 1942, the taxpayer has $16,402.50 net income, all of which is earned income. The net income for the 12-month period from January 1, 1942, to December 31, 1942, including the earned net income for such period, is, therefore, $11,000, of which $9,000 is earned income. The taxpayer files an application under the provisions of paragraph (c) of this section for a reduction of his tax for the short period from the net income for the 12-month period from January 1, 1942, to December 31, 1942, and the excess profits tax for the 12-month period, or $9,000, is earned income. The taxpayer may be entitled to a credit under section 47 (c) (2) by reference to the actual net income for the 12-month period from January 1, 1942, to December 31, 1942, $9,000, 00.

Net income for 12-month period
January 1, 1942, to December 31, 1942 $11,000.00
Less: Personal exemption
1,200.00
Surtax net income
9,800.00
Less: Earned income credit (10 percent of $9,000)
900.00
Net income subject to normal tax
9,000.00
Normal tax (6 percent of $9,000)
540.00
Surtax on $9,000
210.00
Total tax for period 12,750.00

Example (2). The facts are the same as in example (1) of this paragraph, except that during the period from November 1, 1942, to December 31, 1942, the taxpayer has no income, but has deductible business expenses of $1,000. His net income for the 12-month period from January 1, 1942, to December 31, 1942, including his earned net income, is, therefore, $9,000, of which $4,000 is earned income. The taxpayer files an application under paragraph (c) of this section for a reduction of his tax for the short period from the net income for the 12-month period from January 1, 1942, to October 31, 1942, without placing such net income on an annual basis, or $2,256 (see example (1)). The tax computed under section 47 (c) (2) by reference to the actual net income for the 12-month period from January 1, 1942, to December 31, 1942, is $2,256, or 90 percent of $2,500.

Net income for 12-month period
January 1, 1942, to December 31, 1942 $9,000.00
Less: Personal exemption 1,200.00
Surtax net income 7,800.00
Less: Earned income credit (10 percent of $4,000) 400.00
Surtax net income 7,400.00

Normal tax (6 percent of $7,000) 840.00
Surtax on $7,000 510.00
Total tax for period 8,750.00

Since the tax computed on the basis of the net income for the short period without placing such net income on an annual basis, or $2,256, is greater than the $2,250, the tax computed by reference to the actual net income for the short period, the excess profits tax for the short period under section 47 (c) (2) is $2,256.

Example (3). The facts are the same as in example (2) in paragraph (a) of this section. The taxpayer applies to have his tax reduced under section 47 (c) (2). During the 4-month period from September 1, 1942, to December 31, 1942, the X Corporation has $10,000 net income, including $2,500 dividends from a domestic corporation for which the credit provided in section 26 (b) is applicable and $1,000 interest on obligations of the United States described in section 25 (a), and its excess profits net income computed for such 4-month period is $2,600. The net income for the 12-month period from January 1, 1942, to December 31, 1942, is, therefore, $18,931.75. For such 12-month period, the dividends from domestic corporations for which the credit provided in section 26 (b) is applicable amount to $15,000, and the excess profits tax on United States obligations described in section 26 (a) amounts to $5,000. The excess profits tax for the short period is $6,160. The excess profits tax for the taxable year from September 1, 1942, to August 31, 1943, which includes the last four months of the 12-month period, is $6,250, and the excess profits net income for such period is $25,000. The tax for the short period is reduced under section 47 (c) (2) to $15,480.61, computed as follows:

January 1, 1942, to December 31, 1942 $558,000.00
Excess profits tax for fiscal year September 1, 1942, to August 31, 1943 43,200.00
Excess profits net income for period September 1, 1942, to August 31, 1943 12,000.00
Excess profits net income for fiscal year September 1, 1942, to August 31, 1943 86,000.00

Portion of excess profits tax allocable to period September 1, 1942, to December 31, 1942
(12,000 $4,834,200) 4,600.00
Excess profits tax imposed for 12-month period January 1, 1942, to December 31, 1942 $8,930.00
Excess profits net income for 12-month period January 1, 1942, to December 31, 1942 (amount of which for which tax for 12-month period is 10 percent) $1,160.00

Normal tax net income 6,025.00
Less: Credit provided in section 26 (a) for interest on United States obligations 5,000.00
Surtax net income 1,025.00

Normal tax on annual income 46,025.00
Surtax on $61,025.00 10,765.75
Total tax on annual income 56,790.75

Net income for 8-month period January 1, 1942, to August 31, 1942 72,000.00
Net income for 12-month period January 1, 1942, to December 31, 1942 90,000.00
Amount of tax for 8-month period (10,000 $4,834,200) 2,602.22
9,000 2,602.22
Total tax on annual income 18,811.75

Net income for 10-month period January 1, 1942, to October 31, 1942 $10,000.00
Net income for 12-month period from January 1, 1942, to December 31, 1942 11,000.00
Amount of tax for 10-month period (11,000 $2,500) 2,292.73
The amount of tax that would be due if the income for the short period were not placed on an annual basis is $2,296, computed as follows:

Net income for 10-month period
January 1, 1942, to October 31, 1942 $10,000.00
Loss: Personal exemption
1,200.00
Surtax net income
8,800.00
Less: Earned income credit (10 percent of $4,000) 400.00
Net income subject to normal tax
8,400.00
Normal tax (6 percent of $8,400) 504.00
Surtax on $8,400 540.00
Total tax for period 2,292.73

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the twelfth month after the beginning of the short period. In this case, the taxpayer must file its application not later than December 31, 1942, the time prescribed for filing a return, or the return will then be considered as if the taxpayer had made under this chapter and such other income and deduction schedules as may be deemed necessary by the Commissioner for the purpose of carrying out the provisions of this chapter or under regulations prescribe- for returns in the same manner as in the case of an overpayment.

Sec. 60. Forms of Returns [as amended by sec. 136 (d), Rev. Act 1943].

When used in this chapter—
(a) "Taxable year." "Taxable year" means the calendar year, or the fiscal year ending during such calendar year, or the fiscal year ending during such taxable year. In the case of a taxpayer entitled as the head of a family, such period of twelve months ending with the close of the fiscal year will be considered as the taxable year for the purpose of computing the income and the deductions and credits allowed under this chapter and such other income and deduction schedules as may be deemed necessary by the Commissioner for the purpose of carrying out the provisions of this chapter or under regulations prescribe.

(b) "Fiscal year." "Fiscal year" means an accounting period of twelve months ending on the last day of any month other than December.

(c) "Paid or incurred." "Paid or incurred" shall be construed according to the method of accounting upon the basis of which the income is computed under this Part.

(d) "Trade or business." The term "trade or business" includes the performance of the functions of a public office.

RETURNS AND PAYMENT OF TAX

Sec. 61. Individual returns [as amended by sec. 29.25-7, Rev. Act 1940; sec. 112 (a), Rev. Act 1941; sec. 151 (c), 150 (a), Rev. Act 1942].

(a) Requirement. Individuals shall each make a return, which shall contain stating specifically the items of his gross income and the aggregate gross income and the aggregate gross income of the two, $1,200 or over; or

(i) Such individual and his or her spouse each has for the taxable year a gross income and the aggregate gross income of the two is $1,200 or over; or

(ii) Such individual has for the taxable year a gross income and the aggregate gross income of such individual and his or her spouse is equal to, or in excess of, the credit allowed by section 25 (b) (1) and (3) (computed without regard to any credit to which either or both may be entitled as the head of a family) (see §29.25-7).

(b) Joint returns. A husband and wife, if living together at the close of the taxable year, may elect to make a joint return (see section 51 (b)) that is, to include in a single return made by them jointly the income and deductions,
of each, even though one has no gross income. In such a case, the tax shall be computed on the income which the liability with respect to the tax shall be joint and several. If one spouse dies prior to the last day of the taxable year, the surviving spouse may not include the income of the deceased spouse in the joint return for such taxable year. A joint return may not be made if either the husband or wife is a nonresident alien.

A joint return of a husband and wife (not made by an agent, see §29.51-2) shall be signed by both spouses. An oath is not necessary, but both spouses shall verify the return as provided in section 51. If signed by one spouse as agent for the other, authorization for such action must accompany the return. (See §29.51-2.) The spouse acting as agent for the other shall, with the principal, assume the responsibility for making the return and incur liability for the penalties provided for erroneous, false, or fraudulent returns.

For returns by fiduciaries, see section 142; by partnerships, see section 187; and by nonresident alien individuals, see section 217. For time and place for filing returns, see section 53.

§ 29.51-2 Form of return. The return shall be on Form 1040 except that it may be reduced to Form 1040A if (1) the gross income does not exceed $3,000 and consists wholly of salary, wages, compensation for personal services, dividends, interest, or annuities, (2) the return is made on the cash basis, and (3) the taxpayer (if not excluded by section 404) elects to pay the tax imposed by section 401 in lieu of the tax imposed by sections 11 and 13. The forms may be had from the collectors of the several districts. The return may be made by an agent if, by reason of illness, the person liable for the making of the return is unable to do so. The return may also be made by an agent if the taxpayer is unable to make the return by reason of continuous absence from the United States for a period of at least 60 days prior to the time prescribed by law for making the return. Whenever a return is made by an agent it must be accompanied by the prescribed power of attorney, Form 2848, except that an agent holding a valid and subsisting general power of attorney authorizing him to represent his principal in making, executing, and filing the income return, may submit a certified copy thereof in lieu of the authorization on Form 2848. The taxpayer and his agent, if any, are responsible for the return as made and incur liability for the penalties provided for erroneous, false, or fraudulent returns.

For returns of nonresident aliens, see §§ 29.217-1 and 29.217-2.

The home or residential address of the taxpayer (including the street and number, if applicable) shall be given in the space provided at the top of the return for the name and address of the taxpayer. A taxpayer having a permanent business address may give that address as the principal or mailing address, provided that the collector's home or residential address is also given within the space provided.

§ 29.51-3 Return of income of minor. An individual, although a minor, who is single, is required to render a return of income if he has gross income of his own of $500 or over for the taxable year, regardless of the amount of his net income. If the aggregate of the gross income of such a minor from any property which he possesses, and from any funds held in trust for him by a trustee or guardian, and from his earnings which belong to him, is at least $500, regardless of the amount of his net income, a return, as in the case of any other individual, must be made by him or for him by his guardian, or other person charged with the care of his person or property. (See §29.162-2.) If he is married, see §29.51-1. If, under the laws of a State the earnings of a minor belong to the minor, such earnings, regardless of amount, are not required to be included in the return of the parent. In the absence of proof to the contrary, a parent will be assumed to have the legal right to the earnings of the minor and must include them in his return.

§ 29.51-4 Verification of returns. (a) A return of an individual required to be filed under section 51 shall contain or be verified by a written declaration that it is made under the penalties of perjury. All other income tax returns must be verified under oath or affirmation. The oath or affirmation may be administered by any person duly authorized to administer oaths for general purposes by the law of the United States or of any State, Territory, or possession of the United States, or of the District of Columbia, wherein such oath or affirmation is administered, or by a consular officer of the United States. Persons in the naval or military service of the United States may, before any officer authorized to administer oaths for the purposes of those respective services, make returns extending abroad. The oath or affirmation may be administered either before an internal revenue officer, or before any other officer having knowledge of the appointment and official character of the attesting officer.

(b) Income tax returns actually prepared by other persons for individuals required to file returns under section 51 shall be verified as provided in section 54. If any person or persons actually prepare any other income return for another person, the prescribed form of affidavit on the return shall be subscribed and sworn to by such person or persons preparing the same. Such affidavit is required on all such income returns required under the Internal Revenue Code except the following:

(1) Returns required under sections 143 and 144 (relating to withholding of tax at the source);

(2) Returns required to be made by departing aliens under section 146;

(3) Returns required under sections 147, 148, and 149 (relating to information at source);

(4) Returns by subsidiary corporations included in consolidated returns; and

(5) Returns required under sections 301, 339, and 361 (relating to monthly information returns filed by officers and directors, and also monthly and annual information returns filed by certain shareholders, of certain foreign corporations, and returns of foreign corporations).

Such affidavit is not required if the actual preparation of the return is a regular and usual incident of the employment of one regularly and continuously employed for full time by the person for whom the return is made (see in the case of any other officer or employee of the Bureau of Internal Revenue, the affiliate of the officer, bookkeeper, accountant, etc.). If, however, the employee is not regularly or continuously employed by the person for whom the return is made for the full time, or the actual preparation of the return is not a regular and usual incident of such employment, the requirements of this paragraph apply. Thus, if the return is prepared by an accountant or firm of accountants making periodical audits of the accounts of the person for whom the return is prepared, the affidavit is required. If the return is a separate return of a married person, the affidavit is required, although the one actually preparing the return is the husband or wife of the taxpayer. A person who renders mere mechanical assistance or preparation as, for example, a stenographer or typist, is not considered as preparing the return. If, in the course of his official duties, a deputy collector, an internal revenue agent, or other officer or employee of the Bureau of Internal Revenue actually prepares the return, the person for whom the return is made shall make in the return a brief statement that he did so, and it will not be necessary to make the sworn statement required by this paragraph.

§ 29.51-5 Use of prescribed forms. Copies of the prescribed return forms will so far as possible be furnished taxpayers by collectors. A taxpayer will not be excused from making a return, however, by the fact that no return form has been furnished to him. Taxpayers not supplied with the proper forms should make application therefor to the collector in ample time to have their returns prepared, verified, and filed with the collector on or before the due date. Each taxpayer should carefully prepare his return as fully and clearly to set forth the data therein called for. Returns which have not been so prepared will not be accepted as meeting the requirements of the Internal Revenue Code. In lack of a prescribed form a return may be prepared by a taxpayer of the income tax on his gross income and the deductions therefrom may be accepted as a tentative return, and if filed within the prescribed time the statement so made will relieve the taxpayer from liability to penalties, provided that without unnecessary delay
such a tentative return is supplemented by a return made on the proper form. (See further §§ 29.53-2 to 29.53-5, inclusive.)

Sec. 52. Corporation returns [as amended by sec. 189 (f), Rev. Act, 1943].

(a) Every corporation subject to taxation under this chapter shall make a return, stating specifically the items of its gross income and deduction of expenses and credits allowed by this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner of Internal Revenue may by regulations prescribe. The return shall be sworn to by the president, vice president, or other officer to whom is entrusted the custody, control, or care of the books, records, and papers of the corporation, or by the treasurer, assistant treasurer, or chief accounting officer. 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 and form as corporations are thereby 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 and form as corporations are thereby 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 and form as corporations are thereby required to make returns.

§ 29.52-2 Returns by receiver. Receivers, trustees in dissolution, trustees in bankruptcy, and assignees operating the property or business of corporations, must make returns of income for such corporations. If a receiver has full custody of and control over the business or property, he shall be deemed to be operating such business or property within the meaning of section 52, whether he is engaged in carrying on the business for which the corporation was organized or only in marshaling, selling, and disposing of its assets for purposes of liquidation. Notwithstanding that the powers and functions of a corporation are suspended and that the property and business of such corporation are being carried on by the receiver, trustee, or assignee, the corporation 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. (See sections 274 and 208 and §§ 29.274-1 and 29.274-2.) A receiver in charge of only part of the property of a corporation, however, as, for example, a receiver in mortgage foreclosure proceedings involving merely a small portion of its property, need not make a return of income.

Sec. 53. Time and place for filing returns.

(a) Time for filing—(1) General rule. Returns, made on the basis of the calendar year shall be made on or before the 15th day of March following the close of the calendar year. Returns made on the basis of any fiscal year shall be made on or before the 15th day of the third month following the close of the fiscal year. (2) Extension of time. The Commissioner may grant a reasonable extension of time for the making of returns, under such rules and regulations as he shall prescribe with the approval of the Secretary. Except in the case of tax-payers who are abroad, no such extension shall be for more than six months. (b) To whom return made—(1) Individuals. Returns (other than corporation returns) shall be made to the collector for the district in which 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 of the district in which is located the 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. (2) Corporations. Returns of corporations shall be made to the collector of the district in which is located the principal place of business of the corporation or of an 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.

§ 29.53-1 Time for filing returns. Returns of income (except in the case of nonresident alien individuals, as to which see section 217, and foreign corporations, as to which see section 235, and except in the case of a return for a fractional part of a year ending on or before the 15th day of the fourth month following the close of the taxable year, the return by a taxpayer (other than a nonresident alien individual or nonresident foreign corporation) for a fractional part of a year beginning in 1943 and ending in that year shall be made on or before March 15, 1943. In all other cases, the return (other than a return by a nonresident alien individual or foreign corporation) for a fractional part of a year shall be made on or before the 15th day of the third full calendar month following the close of the fractional part of a year, except that upon a showing by the taxpayer of unusual circumstances, the Commissioner may prescribe a later time for the filing of the return. In such a case, the time prescribed by the Commissioner shall not be later than the 15th day of the fifteenth month ending after the beginning of the part of the year for which the return is made. A corporation going into liquidation during any taxable year may, upon the completion of such liquidation, prepare a return for that year covering its income for the part of the year not included in its return for the preceding year, and file such return with the collector. See also section 148 (d) and (e). For provisions relating to the circumstances under which such returns may be filed, see Part § 472 of this chapter.

§ 29.53-2 Extensions of time for filing returns. It is important that the taxpayer render on or before the due date a return nearly complete, to which it is possible for him to prepare. However, the Commissioner is authorized to grant a reasonable extension of time for filing returns under such rules and regulations as he shall prescribe with the approval of the Secretary. Accordingly, authority for granting extensions of time for filing income tax returns is hereby delegated to the various collectors of internal revenue. Application for extensions of time for filing income tax returns should be addressed to the collector of internal revenue for the district in which the taxpayer files his returns and must contain a full recital of the facts upon which the extension is sought. In the case of taxpayers who are abroad, no extension for filing income tax returns may be granted for more than six months. For extensions of time for payment of tax, see sections 56 (c) and 272 (1) and §§ 29.53-3, 29.53-5, and 29.272-3.

§ 29.53-3 Extensions of time in the case of foreign organizations, certain domestic and foreign partnerships and associations, etc.
mestic corporations, citizens of United States residing or traveling abroad, and nontaxable returns of fiduciaries for estates or trusts. (c) Extension of time for filing returns of income for taxable years beginning after December 31, 1941, is hereby granted to and including the 15th day of the sixth month following the close of such year in the case of:

1. Foreign partnerships regardless of whether they maintain an office or place of business within the United States;
2. Foreign corporations which maintain an office or place of business within the United States;
3. Domestic corporations which transact their business and keep their books of account abroad;
4. Domestic corporations which derive their principal income from sources within the possessions of the United States; and
5. American citizens residing or traveling abroad, including persons in military or naval service on or before the due date.

(b) nontaxable returns of income for taxable years beginning after December 31, 1941, is hereby granted to and including the 15th day of the sixth month following the close of such year in the case of:

1. Individuals; and
2. Foreign corporations which derive from the date they are required to be filed such income or credits, and other matters required to be shown in any return under chapter 1.

An extension of time for filing a return in the case of failure to file the return within the prescribed time, see section 291.

§ 29.53-5 Place for filing individual returns. Section 53 (b) (1) provides that individual 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, Md.

An individual employed on a salary or commission basis who is not also engaged in conducting a commercial or professional enterprise for profit on his own account does not have a "principal place of business" within the meaning of section 53 (b) (1), and shall make his return to the collector for the district in which is located his legal residence, or, if he has no legal residence in the United States, then to the collector at Baltimore, Md.

§ 29.54-1 Records and income tax forms. Every person subject to the tax, except persons whose gross income (a) consists solely of salary, wages, or similar compensation for personal services rendered, or (b) arises solely from the business of growing and selling products of the soil, shall, for the purpose of enabling the Commissioner to determine the correct amount of income subject to the tax, keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of the gross income and the deductions, credits, and other matters required to be shown in any return under chapter 1. Such books or records shall be kept at all times available for inspection by internal revenue officers, shall be retained so long as the contents thereof may become material in the administration of any internal-revenue law.

Income-tax forms shall be prescribed by the Commissioner, and so forth, as to formation, content and form, and shall be prescribed in accordance with the regulations and the instructions on the form or issued therewith.

Sec. 54. Records and special returns. (a) By taxpayers. Every person liable to any tax imposed for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

(b) To determine liability to tax. Whenever in the judgment of the Commissioner necessary he may require any person, by notice served upon him, to make a return, render under oath, such statements, or keep such records, as the Commissioner deems sufficient to show whether or not such person is liable to tax under this chapter.

(c) Information at the source. For requirement of persons, by means of the use of any one person to assist in determining the tax liability of another person, see sections 147 to 150.

(d) Copies of returns. If any person, required by this chapter to file a copy of any income return for any taxable year, fails to file such copy at the time required, there shall be due and assessed against such person in the case of an individual return or § 610 in the case of a fiduciary, partnership, or corporation return, and the person to whom the return is filed shall prepare such copy. Such amount shall be collected and paid, without interest, in the same manner as the amount of tax due in excess of that shown by the taxpayer upon a return in the case of a mathematical error appearing on the face of the return.

For information returns by officers, directors, and large shareholders, with respect to foreign corporations, see sections 338, 339, and 340.

For information returns by attorneys, accountants, and so forth, as to formation, see sections 338, 339, and 340.

For information returns by officers, directors, and so forth, as to formation, so forth, of foreign corporations, see section 3604.

§ 29.54-6 Place for filing individual returns. Every person subject to the tax must file his return, and so forth, of foreign corporations, see section 3604.

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may be furnished to any official, body, or commission of any political subdivision of such State, or any person authorized by the State to administer the Internal revenue laws of such political subdivision, but may be furnished only for the purpose used or applied only for, the administration of such tax laws.

(c) Inspection by shareholders. All bona fide shareholders owning a centum or more of the outstanding stock of any corporation shall, upon making request of the Commissioner, be allowed to examine the annual report or certified copy of the annual report of such corporation and of its subsidiaries.

(d) Inspection by committees of Congress—

(1) Committees on Ways and Means or the Committee on Finance may bring to the attention of the Senate, or to both the Senate and the House, or to both the House and the Senate, at any time, the failure to grant it will result in unreasonable delay or expense.

(2) The Secretary and any officer or employee of the Treasury Department, upon request from the Committee on Ways and Means or the Committee on Finance of the Senate, or a select committee of the Senate or House, or any committee of the Senate or House designated by such committee sitting in executive session with any data of any character contained in or shown by any return.

(3) Any such committee shall have the right, acting directly as a committee, or by or through such examiners or agents as it may designate, to inspect any or all of the returns at such times and in such manner as it may determine.

(4) Any such committee, thus obtained may be submitted by the committee obtaining it to the Senate or the House, or to both the Senate and the House, as the case may be.

(e) Inspection in collector's office of list of taxpayers. The collector of the Internal revenue district shall have the same right to obtain data and inspect returns as the Committee on Ways and Means or the Committee on Finance of the Senate, or a select committee of the Senate or House, or any committee of the Senate or House designated by such committee sitting in executive session with any data of any character contained in or shown by any return.

(f) Penalties for disclosing information—

(1) Federal employees and other persons. It shall be unlawful for any 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 amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any such return, or to sell, lease, or dispose of any such return, or any portion thereof, for more than $1,000 or by imprisonment for not more than one year, or both.

(2) Shareholders. Any shareholder 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 shall upon conviction be punished by a fine of not more than $1,000 or by imprisonment for not more than one year, or both.

(3) Cross references. For penalties for disclosure of information, see section 3511. For any income return or copy thereof or any part thereof, set forth or disclosed in any such return, shall be guilty of a misdemeanor and shall upon conviction be punished by a fine of not more than $1,000 or by imprisonment for not more than one year, or both.

(g) Cross references. For penalties for disclosure of information, see section 3511. For any income return or copy thereof or any part thereof, set forth or disclosed in any such return, shall be guilty of a misdemeanor and shall upon conviction be punished by a fine of not more than $1,000 or by imprisonment for not more than one year, or both.

(h) Extension of time for payment—(1) General rule. At the request of the taxpayer, the Commissioner may extend the time for payment of the amount determined as the tax by the taxpayer, or any installment thereof, for a period not to exceed five years from the date prescribed for the payment of the tax or an installment thereof. In such case the extension is granted shall be paid on or before the date fixed for its payment, the whole amount of the tax unpaid shall be paid upon the same terms and conditions as if paid on or before the date fixed for its payment.

(2) Liquidation of personal holding company. At the request of the taxpayer, the Commissioner may liquidate such personal holding company, (under regulations prescribed by the Commissioner with the approval of the Secretary) extend for a period not exceeding five years from the date prescribed for the payment of the tax the time for payment or payment of the tax the time for payment of such portion of the amount determined as the tax by the taxpayer, or any installment thereof, for a period not to exceed five years from the date prescribed for the payment of the tax or an installment thereof. In such case the extension granted shall be paid on or before the date of the expiration of the period of the extension.

(i) Liquidation of personal holding company. At the request of the taxpayer, the Commissioner may liquidate such personal holding company, (under regulations prescribed by the Commissioner with the approval of the Secretary) extend for a period not exceeding five years from the date prescribed for the payment of the tax the time for payment of such portion of the amount determined as the tax by the taxpayer, or any installment thereof, for a period not to exceed five years from the date prescribed for the payment of the tax or an installment thereof. In such case the extension granted shall be paid on or before the date of the expiration of the

(j) Liquidation of personal holding company. At the request of the taxpayer, the Commissioner may liquidate such personal holding company, (under regulations prescribed by the Commissioner with the approval of the Secretary) extend for a period not exceeding five years from the date prescribed for the payment of the tax the time for payment of such portion of the amount determined as the tax by the taxpayer, or any installment thereof, for a period not to exceed five years from the date prescribed for the payment of the tax or an installment thereof. In such case the extension granted shall be paid on or before the date of the expiration of the
extension. If an extension is granted under this paragraph the Commissioner may require the taxpayer to furnish a bond in such amount, not exceeding double the amount with respect to which the extension is granted, and with such sureties as the Commissioner deems necessary, conditioned upon the payment of the tax or installment thereof in accordance with the terms of the extension.

(c) Advance payment. A tax imposed by this chapter, or any installment thereof, may be paid, at the election of the taxpayer, prior to the date prescribed for its payment.

(e) Advance payment in case of jeopardy. For advance payment in case of jeopardy, see section 29.56-4.

(f) Tax withheld at source. For requirements of withholding tax at source, see sections 143, 144, and Part II of Subchapter D.

(g) Fractional parts of cent. In the payment of any tax under this chapter 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.

(h) Receipts. Every collector to whom any payment is made shall, upon request given to the person making such payment a full written or printed receipt thereof.

§ 29.56-1 Date on which tax shall be paid. The tax is required to be paid at the source (see sections 143 and 144) or unless it is to be paid by a nonresident alien individual (see section 218) or a foreign corporation not having any office or place of business within the United States (see section 236), is to be paid on or before the 15th day of March following the close of the calendar year, or, if the return is made on the basis of a fiscal year, before the 15th day of the month following the close of such fiscal year. In the case of a return (other than a return by a nonresident alien individual or nonresident foreign corporation) for a fractional part of a year, the tax is to be paid on or before the last day prescribed for the filing of the return (see § 29.53-1). But see § 29.53-5. The tax may, at the option of the Government, be paid in full by the installments instead of in a single payment, in which case the first installment is to be paid on or before the date prescribed for the payment of the tax as a single payment, to be followed by installments on or before the 15th day of the third month following the close of such fiscal year. If the Government, at the time for the payment of one installment does not receive the tax, or an amount not exceeding double the amount of the tax, the Commissioner may require a bond to be given to the Government in an amount not exceeding double the amount of the tax, by the person making such payment, with sureties as the Commissioner may require.

§ 29.56-2 Extension of time for payment of tax or installment thereof. If it is shown to the satisfaction of the Commissioner that the payment of the amount determined as the tax by the taxpayer or any part or installment thereof upon the date or dates prescribed for the payment thereof will result in undue hardship to the taxpayer, the Commissioner, at the request of the taxpayer, may grant an extension of time for the payment for a period not to exceed six months, or for the payment of an installment, part, or installment, except that the extension may be for a period not to exceed five years from the date prescribed for the payment of the tax in the case of such payment for a period not to exceed five years from the date prescribed for the payment thereof, the amount determined as the tax by the taxpayer which is attributable to the short-term or long-term capital gain derived by the taxpayer from the receipt of property other than money, when the complete liquidation (as defined in section 115 (c)) of a corporation if the corporation, for its taxable year preceding the year in which occurred the complete liquidation (or the first of the series of distributions referred to in section 115 (c)), was, under the law applicable to such taxable year, a personal holding company or a foreign personal holding company. An extension of time for payment may be granted, in a general statement of hardship. The term "undue hardship" means more than an inconvenience to the taxpayer. It must appear that substantial financial loss, for example, due to the sale of property at a sacrifice price, will result to the taxpayer from making payment of the amount at the due date. If a market exists, the sale of property at the current market price is not ordinarily considered as resulting in undue hardship.

An application for an extension of time for the payment of such tax should be made under oath on Form 1130 and must be accompanied by evidence showing the undue hardship that would result to the taxpayer if the extension were refused. A sworn statement of assets and liabilities of the taxpayer and an itemized statement under oath showing all receipts and disbursements for the three months immediately preceding the due date of the tax are required and should accompany the application. The application, with the evidence, must be filed with the collector, who will transmit it to the Commissioner with his recommendations as to the extension. When it is received by the Commissioner, it will be examined and, if possible, within 30 days will be denied, granted, or tentatively granted. A decision to grant an extension of the tax or installment thereof for which the extension is desired, or on or before the date or dates prescribed for payment in any prior extension granted.

As a condition to the granting of such an extension, the Commissioner will usually require the taxpayer to furnish a bond on Form 1130 in an amount not exceeding double the amount of the tax or installment thereof of the spouses of such members, or of such other circumstances. The Commissioner will not consider an application for an extension of time for the payment of a tax unless therefor is made to the collector on or before the date prescribed for payment of the tax or installment thereof for which the extension is desired, or on or before the date or dates prescribed for payment in any prior extension granted.

For provisions relating to certain cases in which the date otherwise prescribed for the payment of the tax or an installment thereof is postponed by reason of a member (whether or not the taxpayer) of the military or naval forces of the United States serving on sea duty or outside the continental United States, see parts of this chapter.

§ 29.56-3 When fractional part of cent may be disregarded. In the payment of taxes a fractional part of a cent shall be disregarded unless it amounts to one-half cent or more. In which case it shall be increased to 1 cent. Fractional parts of a cent should not be disregarded in the computation of taxes.

§ 29.56-4 Receipts for tax payments. Upon request a collector will give a re-
cept for each tax payment. In the case of payments made by check or money order the canceled check or the money order receipt is usually a sufficient re-
cipt. In the event of taxes being in arrears, however, the taxpayer should in every instance require and the collector should furnish a receipt.

SEC. 57. EXAMINATION OF RETURN AND DE-
TERMINATION OF TAX.

As soon as practicable after the return is filed the Commissioner shall examine it and shall determine the correct amount of the tax.

§ 29.57-1. Examination of return and determination of tax by the Commissioner.

As soon as practicable after returns are filed, they will be examined and the correct amount of the tax determined under such procedure as may be prescribed from time to time by the Commissioner. (See section 272.)

SEC. 58. DECLARATION OF ESTIMATED TAX BY IN-
dividuals (as added by sec. 5 (a), Current Tax Payment Act 1943).

(a) Requirement of declaration. Every in-
dividual (other than an estate or trust and other than a nonresident alien with respect to whose income the provisions of this chapter being withholding under Subchapter D of Chapter 9 is not made applicable) shall, at the time of the taxable year prescribed in sub-
section (d), make a declaration of his esti-
mated tax for the taxable year if—

(1) his gross income from wages (as de-

fined in section 1621)

(A) in case such individual is single or
married but not living with husband or wife;

or

reasonably expected to exceed $3,500
for the taxable year; or did exceed $2,700
for the preceding taxable year; or

(B) in case such individual is married and
living with husband or wife: can, when added
to the gross income which can reasonably
be expected to be received from wages (as
defined) for the preceding taxable year, exceed
$3,500 for such preceding taxable year.

(2) his income other than wages (as
defined) for the taxable year and his gross
income to

(A) in case such individual is single or
married but not living with husband or

or

(B) in case such individual is married and
living with husband or wife: can, when added
to the gross income which can reasonably
be expected to exceed $3,500 for the taxable
year; or did exceed $2,700 for the preceding taxable year; or

(3) the excess of the amount estimated
under paragraph (1) over the amount esti-
mated under paragraph (2), which excess for the purposes of this chapter shall be held and considered the estimated tax for the taxable year.

The declaration shall also contain such other
information as may be necessary for carrying out the provisions of this chapter as the Com-
missioner, with the approval of the Secre-
tary, may prescribe, and shall contain or be verified by a written statement that it is made under the penalties of
perjury.

(c) Joint declaration by husband and
wife. In the case of a husband and wife
living together, a single declaration under
this subsection may be made jointly. In which case the liability with respect to the
estimated tax shall be joint and several.

No joint declaration shall be made in which
either the husband or wife is a nonresident alien.

If a joint declaration is made but a joint
return is not made for the taxable year, the
husband or wife may be treated as the estimated tax of either the husband or the wife, or may be divided
between them.

(d) Time and place for filing. The dec-
claration required under subsection (a) shall
be filed on or before the fifteenth day of the
third month of the taxable year, except that

(1) if the declaration is filed after the ret-
turns are due, the Commissioner shall ex-
amine it and shall determine the correct
amount of the tax determined under such
procedure as may be prescribed from time
to time by the Commissioner.

(2) if the declaration is filed otherwise
than pursuant to an extension of time after
the fifteenth day of the month of the third
month of the taxable year, the estimated tax
in equal installments the number of which is
equal to the number of quarters remaining in
the taxable year (including the quarter in
which the declaration is filed); and

(3) if any amendment or revision of a
declaration is filed, the remaining install-
ments shall be ratably increased or decreased,
as the case may be, to reflect the increase or
decrease, as the case may be, in the esti-
mated tax by reason of such amendment or
revision; and

(4) if the declaration is filed after the ret-
turns are due, the Commissioner shall ex-
amine it and shall determine the correct
amount of the tax determined under such
procedure as may be prescribed from time
to time by the Commissioner.

SEC. 59. PAYMENT OF ESTIMATED TAX (as
added by sec. 5 (a), Current Tax Payment
Act 1943).

(a) In general. The estimated tax shall be
paid in four equal installments except that

(b) Assessment. The estimated tax shall
be assessed only to the extent paid. (No-
ne: see section 220, Current Tax Payment
Act 1943, effective with respect to tax-
able years beginning after December 31, 1942.)

One installment of the estimated tax shall
be paid at the time of making the declar-
ation and an installment thereof shall be
paid on or before the fifteenth day of each
quarter of the taxable year. Payment of any installment of the estimated tax shall be considered payment on
account of the tax for the taxable year.

(b) Application to taxable years.

The application of sections 58 and 59 to
short taxable years.

The application of sections 58 and 59 to
short taxable years of less than twelve months shall be pro-
scribed by regulations prescribed by the
Commissioner with the approval of the Secre-
tary.

(c) Application to taxable years begin-
ing in 1943.

If the taxable year is the calendar year
1943, the fifteenth day of September, 1943, shall be substituted for the fifteenth
day of the calendar month of the purposes of section 58 (d).

(d) If the taxable year begins in 1943
after January 1, the date which shall be sub-
stituted for the fifteenth day of the third
month of the taxable year shall be the fifteenth day of the month so stated in the
application of the declaration of the estimated tax in the manner provided for in the taxable year for
installments of the estimated tax for such
taxable year payable after September 1, 1943,
shall be due and payable on or before the fifteenth day of the month succeeding the calendar month in which the estimated tax for such taxable year was due and payable with respect to such taxable years beginning after December 31, 1942. The original section 59 consisted of cross-references.)

SEC. 60. SPECIAL RULES FOR APPLICATION
OF SECTIONS 58 AND 59 (as added by sec. 5 (a), Current Tax Payment Act 1943).

(a) Farmers. In the case of an individual
whose estimated gross income from farming
for the taxable year is at least 80 per centum
of the total estimated gross income from all
sources for the taxable year, in lieu of the
amount prescribed in section 58 (d), the de-
clation for the taxable year shall be made
any time on or before the fifteenth day of the
last month of the taxable year.

(b) Application to taxable years.

The application of sections 58, 59, and 204
(a) (3), (4), and (5) to taxable years of
less than twelve months shall be pro-
scribed by regulations prescribed by the
Commissioner with the approval of the Secre-
tary.

(c) Application to taxable years begin-
ing in 1943.

If the taxable year is the calendar year
1943, the fifteenth day of September, 1943, shall be substituted for the fifteenth
day of the calendar month of the purposes of section 58 (d).

(d) If the taxable year begins in 1943
after January 1, the date which shall be sub-
stituted for the fifteenth day of the third
month of the taxable year shall be the fifteenth day of the month so stated in the
application of the declaration of the estimated tax in the manner provided for in the taxable year for
installments of the estimated tax for such
taxable year payable after September 1, 1943,
shall be due and payable on or before the fifteenth day of the month succeeding the calendar month in which the estimated tax for such taxable year was due and payable with respect to such taxable years beginning after December 31, 1942. The original section 60 consisted of cross-references.)
Chapter VI—Solid Fuels Administration

§ 602.101 Definitions. (a) "Anthracite" means coal which is generally referred to as Pennsylvania anthracite and is produced in the following counties in Pennsylvania: Carbon, Columbia, Dauphin, Lebanon, Lackawanna, Luzerne, Northumberland, Schuylkill, Susquehanna, and Wayne; and is limited to the sizes generally known as broken, egg, stove, chestnut, pea, No. 1 buckwheat and No. 2 buckwheat (rice).

(b) "Retail dealer" means any person who purchases anthracite for resale to consumers.

(c) "Ten days' supply" includes all anthracite coal of any usable kind, grade or size in the consumer's bin required by him to meet minimum anthracite requirements of the consumer for a ten-day period.

§ 602.102 Restrictions upon anthracite deliveries by retail dealers. (a) No retail dealer shall deliver any anthracite coal to any consumer if such consumer has more than a ten days' supply; and no consumer shall accept delivery of any anthracite coal from a retail dealer if such consumer has more than a ten days' supply.

(b) A retail dealer may deliver anthracite coal up to but not in excess of one-half ton to any household consumer if such consumer has less than a ten days' supply.

(c) The restrictions of this section shall apply regardless of whether any consumer had title to any coal in the possession of any retail dealer on the effective date of this Regulation.

§ 602.103 Contemplated activities of local committees of the Office of Defense Transportation. (a) It is understood that local committees functioning under the direction of the Office of Defense Transportation, during the period of work stoppages in the anthracite producing districts and during the effective period of this Regulation, ascertain the amount of anthracite in retail yard storage piles available to local committees, will arrange for the pooling of retail dealer deliveries and will coordinate in other ways retail dealer activities in each anthracite consuming community.

(b) It is understood that the local committees functioning under the direction of the Office of Defense Transportation will indicate to the regional offices of the Solid Fuels Administration for War the tonnages of anthracite coal critically needed by those communities having insufficient anthracite to forestall suffering threatened by weather conditions. The Solid Fuels Administrator for War will, in the recommendations of such committees, arrange, so far as practicable and appropriate, for the shipment of sufficient tonnages of anthracite that is now being held, pursuant to direction of the Solid Fuels Administration for War, in the anthracite producing districts for distribution into those communities whose need for anthracite appears to be critical.

§ 602.104 Deliveries are not authorized under Office of Price Administration Ration Order No. 19 in contravention of this regulation. As provided in section 15 of Ration Order No. 19 issued by the Office of Price Administration, no deliveries are authorized to be made under the provisions of that ration order in contravention of the provisions of this regulation.

§ 602.105 Violations. Any person who willfully violates any provisions of this regulation is guilty of a crime, and upon conviction may be fined or imprisoned. In addition, any such person may be prohibited from making or obtaining further deliveries of, or from processing or using material under priority control and may be deprived of priorities assistance.

§ 602.106 Communications. All communications regarding this regulation should be addressed to the Solid Fuels Administrator for War, Washington, D.C.

This regulation shall become effective immediately.


Issued this 30th day of October 1943.

ABE FORNAS,
Acting Solid Fuels Administrator for War.

[F. R. Doc. 43-17706; Filed, November 2, 1943; 9:23 a.m.]

[Reg. 6, Amdt. 1]

Part 602—General Orders and Directives

Deliveries of Anthracite Coal

It is necessary to amend Solid Fuels Administration for War Regulation No. 6 in order to prevent the imposition of undue distribution difficulties upon retail dealers of anthracite coal who serve as a source of supply for larger consumers of anthracite. Accordingly, pursuant to powers conferred by Executive Order No. 9332, Solid Fuels Administration for War Regulation No. 6 is hereby amended as follows:

1. Section 602.102 (b) is amended to read as follows:

§ 602.102 Restrictions upon anthracite deliveries by retail dealers. • • •

(b) A retail dealer may deliver anthracite coal up to but not in excess of one-half ton to any household consumer if such consumer has less than a ten days' supply. A retail dealer may deliver anthracite coal in any quantity to other than household consumers provided that the tonnage delivered, when added to the inventory on hand, does not exceed a ten days' supply.

This amendment shall become effective immediately.

Issued this 1st day of November 1943.

HAROLD L. IECES,
Solid Fuels Administrator for War.

[F. R. Doc. 43-17707; Filed, November 2, 1943; 9:39 a.m.]

Title 32—National Defense

Chapter XI—Office of Price Administration

Part 1351—Food and Food Products (MPR 440)

Edible Tree Nuts

This regulation establishes maximum prices for certain sales of edible tree nuts, both in-shell and shelled, in order to aid in stabilizing the cost of living.
## Regulations

**Title 6—Agricultural Credit**

Chapter II—War Food Administration (Commodity Credit)

[1943 C.C.C. Bean and Pea Form 1, Supp. 2]

**Part 237—1943 Bean and Pea Loans and Purchases**

**Instructions Concerning Bean Purchases by County A.A.A. Committees**

Pursuant to the provisions of Title III, section 302 of the Agricultural Adjustment Act of 1938, as amended (52 Stat. 38; 7 U.S.C. 1940 ed., 1940), Commodity Credit Corporation has authorized the making of loans on dry edible beans and dry edible smooth peas stored on farms in approved storage structures or in approved warehouses, in accordance with the regulations in this part (1943 C.C.C. Bean and Pea Form 1—Instructions). Such regulations are hereby supplemented by the addition, under "C. Purchases", of § 237.38 entitled "Bean purchases by County A.A.A. Committees", reading as follows:

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Text</th>
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<tr>
<td>§ 237.38 Bean purchases by County A.A.A. Committees—(1) Eligible beans.</td>
<td>Eligible beans shall be beans produced in 1943, of the classes specified herein, which grade No. 1 or No. 2 or which can be cleaned or cleaned and picked to grade No. 2 or better.</td>
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<td>(2) Eligible producers.</td>
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<td>(3) Program outline.</td>
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<td>(4) Purchases of beans.</td>
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TITLE 26—INTERNAL REVENUE
Chapter I—Bureau of Internal Revenue
Subchapter A—Income and Excess-Profits Taxes

[Regulations 111]

PART 29—INCOME TAX; YEARS BEGINNING

§ 29.101-1 Proof of exemption. A corporation is not exempt merely because it is not organized and operated for profit. In order to establish its exemption it is necessary that every organization claiming exemption file with the collector for the district in which it is located the principal place of business or principal office, legal personality is apparent by affidavit or a questionnaire as set forth below. An organization claiming exemption under section 101 (1), (3), (4), except a bona fide credit union, (6), (7), (8), (9), (10), (12), (14), or (16) shall file the form of questionnaire appropriate to its activities, filled out in accordance with the instructions on the form or issued therewith. All other organizations claiming exemption, including bona fide credit unions, shall file an affidavit showing the character of the organization, the purpose for which it was organized or operated, its actual activities, the sources of its income and the disposition of such income, whether or not any of its income is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its right to exemption. To each such affidavit or questionnaire shall be attached a copy of the articles of incorporation, declaration of trust, or other instrument of similar import, setting forth the permitted powers or activities of the organization, the by-laws or other code of regulations, and the latest financial statement showing the assets, liabilities, receipts, and disbursements of the organization. An organization claiming exemption under section 101 (5), (6), except organizations organized and operated exclusively for religious purposes, (7), (8), (9), or (14) shall also file with the other information specified herein a return of information on Form 990 relative to the business of the organization for the last complete year of operation: Provided, however, That such return shall not be required of an organization which is organized and operated exclusively for educational and religious purposes, or educational and religious purposes, if no part of its net earnings or assets are distributable to any private shareholder in liquidation or otherwise and if, in the case of an organization exempt under the preceding sentence from the requirement of filing such returns, nor of separately conducted charitable organizations meeting the above conditions as to distributions and compensation, nor of charitable organizations operated under the control of a State or any political subdivision thereof.

The words "private shareholder or individual" in section 101 refer to individuals having a personal and private interest in the activities of the corporation. Although religious or apostolic associations or corporations exempt under section 101 (18) are relieved from paying the tax, they are required to file returns of income (see § 29.101(18)-1).

In the case of the particular classes of organizations listed below, the following additional information shall be embodied in or attached to, and made a part of, the affidavit or questionnaire referred to above:

(a) Mutual insurance companies shall submit copies of the policies or certificates of membership;
(b) In the case of holding companies claiming exemption under section 101 (14), if the organization for which title is held has not been specifically notified in writing by the Bureau of Internal Revenue that it is held to be exempt under section 101, the holding company shall submit the information indicated herein as necessary for a determination of the status of the organization for which title is held.

The collector, upon receipt of the affidavit, or questionnaire, and other papers, will examine them as to completeness and will forward the documents to the Commissioner for decision as to whether the organization is exempt. In addition to the information specified herein, the Commissioner may require such other returns as he shall deem necessary for a proper determination of whether a particular organization is exempt under section 101, and when deemed advisable in the interest of an efficient administration of the internal revenue laws he may in the cases of particular types of organizations provide additional questionnaires or otherwise prescribe the form in which the proof of exemption shall be furnished.

When an organization (other than a mutual insurance company) 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, except that organization exempt or claiming exemption under section 101 (6), (8), except organizations organized and operated exclusively for religious purposes, (7), (9), (10), (12), (14), or (16) shall file annually returns of information on Form 990 with the collector for the district in which it is located the principal place of business or principal office of the organization: Provided, however, That such return shall not be required of an organization which is organized and operated exclusively for educational and religious purposes, or educational and religious purposes, if no part of its net earnings or assets are distributable to any private shareholder in liquidation or otherwise and if, in the case of such organizations claiming exemption, in- crease in the compensation of its owners, managers, trustees, or directors over the amount of such compensation for the last year for which its exempt status under section 101 (6) was approved by the Commissioner. Form 990 will not be required of charitable organizations operated or controlled by religious or educational organizations of the type exempt under the preceding sentence from the requirement of filing such returns, nor of separately conducted charitable organizations meeting the above conditions as to distributions and compensation, nor of charitable organizations operated under the control of a State or any political subdivision thereof. The return of information on Form 990 shall be filed on or before the 15th day of the fifth month following the close of the taxable year. When a mutual insurance company has established its right to exemption under section 101 (11) of the Internal Revenue Code or a corresponding provision of a prior income tax law 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 unless the gross amount received during the taxable year from interest, dividends, rents, and premiums (including deposits and assessments) exceeds $75,000. See § 29.101 (18)-1 with respect to returns by religious or apostolic associations or corporations exempt under section 101 (18). See also sections 275 (a) and 276 (a) with respect to the statute of limitations.

Collectors will keep a list of all organizations held to be exempt to the end that they may occasionally investigate their status and ascertain whether or not

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they are observing the conditions upon which their exemption is predicated.

An organization which is exempt under section 101 is permitted to take in such a business as the improvement of the grade of their products, and the development of better agricultural and horticultural products and without profit; are thus exempt. On the other hand, corporations which have for their principal object the holding of perpetual race meets, the profits from which may inure to the benefit of their shareholders, are not exempt. Similarly, corporations engaged in growing agricultural or horticultural products for profit are not exempt from tax.

[SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS—AS AMENDED BY SEC. 217 (a), REV. ACT. 1939; SEC. 137 (a), 136 (a), REV. ACT. 1942.]

The following organizations shall be exempt from taxation under this chapter—

(a) Labor, agricultural, or horticultural organizations;

§ 29.101 (1)—Labor, agricultural, or horticultural organizations. The organizations, as permitting by section 101 (1) as entitled to exemption from income taxation are those which:

(a) Have no net income inuring to the benefit of any member;

(b) Have no net income inuring to the benefit of any member and donations is used exclusively to accomplish the objects of the organization; and

(c) Have as their objects the betterment of the conditions of those engaged in such pursuits, the improvement of the products, and the development of a higher degree of efficiency in their respective occupations.

Organizations such as county fairs and like associations of a quasi public character, which are designed to encourage the development of better agricultural and horticultural products through a system of awards, and whose income from gate receipts, entry fees, and donations is used exclusively to meet the necessary expenses of upkeep and operation, are thus exempt. On the other hand, associations which have for their principal object, for example, the holding of perpetual race meets, the profits from which may inure to the benefit of their shareholders, are not exempt. Similarly, corporations engaged in growing agricultural or horticultural products for profit are not exempt from tax.

[SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS—AS AMENDED BY SEC. 217 (a), REV. ACT. 1939; SEC. 137 (a), 136 (a), REV. ACT. 1942.]

The following organizations shall be exempt from taxation under this chapter—

(1) Labor, agricultural, or horticultural organizations;

(2) Mutual savings banks, in order that a corporation may be entitled to exemption as a mutual savings bank, it must appear that it is an organization:

(a) Which has no capital stock represented by shares, and

(b) Whose earnings, less only the expenses of operation, are distributable wholly among the depositors.

If it appears that the organization has shareholders who participate in the profits, the organization will not be exempt.

A mutual savings bank need not be incorporated or be under public supervision, unless, in either case a State statute so requires, nor need it serve the public in general, in order to be exempt. It may confine its business to a designated class of individuals, such as employees of a single corporation, without losing its exemption status.

[SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS—AS AMENDED BY SEC. 217 (a), REV. ACT. 1939; SEC. 137 (a), 136 (a), REV. ACT. 1942.]

(2) Mutual savings banks. A mutual savings bank may be entitled to exemption:

(a) If it is owned by and operated exclusively for the benefit of its lot owners who hold such lots for bona fide residential purposes and not for purpose of resale, or

(b) If it is not operated for profit.

Any cemetery corporation chartered for the purpose of providing burials permitted by its charter to engage in any business not necessarily incident to that purpose, is exempt from income tax, provided that no part of its net earnings inures to the benefit of any private shareholder or individual. A cemetery company which fulfills the other requirements of the Internal Revenue Code may be exempt, even though it issues preferred stock entitling the holders to dividends at a fixed rate, not exceeding the legal rate of interest in the State of incorporation, or 8 percent per annum, whichever is greater, on the value of the charterholder or individual, and if a substantial part of the proceeds was issued, provided that its articles of incorporation require:

(1) That the preferred stock shall be retired at par as soon as sufficient funds are available therefore are realized from sales, and

(2) That all funds not required for the payment of dividends upon or for the redemption of prefered stock shall be used by the company for the care and improvement of the cemetery property.

[SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS—AS AMENDED BY SEC. 217 (a), REV. ACT. 1939; SEC. 137 (a), 136 (a), REV. ACT. 1942.]

The following organizations shall be exempt from taxation under this chapter—

(6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

§ 29.101 (6)—Religious, charitable, scientific, literary, and educational organizations and community chests. In order to be exempt under section 101 (6), the organization must meet three tests:

(a) It must be organized and operated exclusively for one or more of the specified purposes;

(b) Its net income must not inure in whole or in part to the benefit of private shareholders or individuals; and

(c) It must not by any substantial part of its activities attempt to influence legislation by propaganda or otherwise.

Corporations organized and operated exclusively for charitable purposes comprise, in general, corporations for the relief of the poor. The fact that a corporation established for the relief of indigent persons may receive voluntary contributions from the persons intended to be relieved will not necessarily deprive it of exemption.

An educational organization within the meaning of the Internal Revenue Code is one designed primarily for the improvement or development of the capabilities of the individual, but, under exceptional
circumstances, may include an association whose sole purpose is the instruction of the public, or an association whose primary purpose is to engage in activities on subjects useful to the individual and beneficial to the community, even though an association of either class has incidental amusement features. An organization formed to engage in activities of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or life organizations but only if 25 percent of the net income consists of amounts collected from members for the sole purpose of meeting losses and expenses. If an organization issues policies for stipulated cash premiums, it is not exempt from taxation under this chapter if it requires advance deposits to cover the cost of the insurance and maintains investments from which more than 15 percent of its income is derived, it is not entitled to exemption. On the other hand, an organization must be entitled to exemption, although it makes advance assessments for the sole purpose of meeting future losses and expenses, provided that the balance of such assessments remaining on hand at the end of the year is retained to meet losses and expenses or is returned to members.

The phrase "of a purely local character" applies to benevolent life insurance associations, and not to the other organizations specified in section 101(10). It applies, however, to any organization seeking exemption on the ground that it is an organization similar to a benevolent life insurance association of a particular community, place, or district, irrespective, however, of political subdivisions. If the activities of an organization are limited only by the borders of a State, it cannot be considered to be purely local in character.

The following organizations shall be exempt from taxation under this chapter—

(10) Mutual insurance companies or associations other than life or marine (including inter insurers and reciprocal underwriters) if the gross amount received during the taxable year from interest, dividends, rents, and premiums (including deposits and assessments) does not exceed $75,000.

§ 29.101(11)–1 Mutual insurance companies or associations. An insurance company is exempt from taxation under this chapter if it is a mutual company or association (other than life or marine) or an interinsurer or reciprocal underwriter and if the gross amount received during the taxable year from interest, dividends, rents, and premiums (including deposits and assessments) does not exceed $75,000. Such a company is not required to file income-tax returns or pay income taxes. This is not exempt from taxation under this chapter—

(10) Benevolent life insurance associations, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or life organizations but only if 25 percent of the net income consists of amounts collected from members for the sole purpose of meeting losses and expenses. If an organization issues policies for stipulated cash premiums, it is not exempt from taxation under this chapter if it requires advance deposits to cover the cost of the insurance and maintains investments from which more than 15 percent of its income is derived, it is not entitled to exemption. On the other hand, an organization must be entitled to exemption, although it makes advance assessments for the sole purpose of meeting future losses and expenses, provided that the balance of such assessments remaining on hand at the end of the year is retained to meet losses and expenses or is returned to members.

The phrase "of a purely local character" applies to benevolent life insurance associations, and not to the other organizations specified in section 101(10). It applies, however, to any organization seeking exemption on the ground that it is an organization similar to a benevolent life insurance association of a particular community, place, or district, irrespective, however, of political subdivisions. If the activities of an organization are limited only by the borders of a State, it cannot be considered to be purely local in character.

The following organizations shall be exempt from taxation under this chapter—

(11) Mutual insurance companies or associations other than life or marine (including inter insurers and reciprocal underwriters) if the gross amount received during the taxable year from interest, dividends, rents, and premiums (including deposits and assessments) does not exceed $75,000.

§ 29.101(11)–1 Mutual insurance companies or associations. An insurance company is exempt from taxation under this chapter if it is a mutual company or association (other than life or marine) or an interinsurer or reciprocal underwriter and if the gross amount received during the taxable year from interest, dividends, rents, and premiums (including deposits and assessments) does not exceed $75,000. Such a company is not required to file income-tax returns or pay income taxes.
operating expenses, must be returned to the proceeds of the sale, less necessary expenses, be turned back to all producers on the basis of the products furnished by them, it is necessary for such an association to keep permanent records which show that the association was operating during the taxable year on a cooperative basis in the distribution of patronage dividends to all producers, provided the value of the products marketed for members does not exceed the value of the products marketed for nonmembers and members. The Code does not require, however, that the association keep ledger accounts with each producer selling supplies and equipment through the association. Any association which purchases supplies and equipment for nonmembers will not be denied a share of the purchase price of a share of stock or of a membership in the association.

An association which has capital stock will not be denied exemption (1) if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of Incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise) will not exceed 15 percent of the value of all its purchases. Business done for the United States or any of its agencies shall be disregarded in determining the right to exemption under this paragraph;

§ 39.101 (12) Farmers' cooperative marketing and purchasing associations. 
(a) Cooperative associations engaged in the business of producing, marketing, purchasing supplies and equipment for farmers, fruit growers, livestock growers, dairymen, etc., and turning back to the producers the proceeds of the sales of their products, less the necessary operating expenses, among the producers upon the basis of the quantity of milk or of butter fat in the milk furnished by such producers, are exempt from income tax and shall not be required to file returns. For instance, cooperative dairy companies which are engaged in collecting milk and disposing of it if the products thereof and distributing the proceeds, less necessary operating expenses, among the producers upon the basis of the quantity of milk or of butter fat in the milk furnished by such producers, are exempt from income tax. If the proceeds of the business are distributed in any other way than such a proportionate distribution, the association does not meet the requirements of the Internal Revenue Code and is not exempt. In other words, nonmember patrons must be treated the same as members in so far as the distribution of patronage dividends is concerned, that is, if products are marketed for nonmember producers, the proceeds of the sale, less necessary operating expenses, must be returned to the producer. If the sale of wholesale products results, whether or not such patrons are members of the association. In order to show its cooperative nature and to establish compliance with the requirements of the Code that the proceeds of sales, less necessary expenses, be turned back to all producers on the basis of the products furnished by them, it is necessary for such an association to keep permanent records which show that the business done both with members and nonmembers. The Code does not require, however, that the association keep ledger accounts with each producer selling supplies and equipment through the association. Any association which purchases supplies and equipment for nonmembers will not be denied exemption under this paragraph; 
(b) Cooperative associations engaged in the purchasing of supplies and equipment for farmers, fruit growers, livestock growers, dairymen, etc., and turning over such supplies and equipment to them at actual cost, plus the necessary operating expenses, are exempt. The term "supplies and equipment" as used in section 101 (12) includes groceries and all other goods and materials to be used by farmers in the operation and maintenance of a farm or farmer's household.

The provisions of paragraph (a) of this section are subject to the condition that the stock purchased with surplus and to capital stock shall apply for the purposes specified in section 101 (12).

An association which purchases supplies and equipment for nonmembers will not be denied exemption, provided the value of the purchases for nonmembers does not exceed the value of the supplies and equipment purchased for members, and provided the ownership of stock by others than such producers does not exceed 15 percent of the value of all of its purchases.

In order to be exempt under either paragraph (a) or (b) of this section an association must establish that it has no net income for its own account other than that reflected in a reserve or surplus authorized in paragraph (a). An association to be entitled to exemption, provided the value of the purchases for nonmembers does not exceed the value of the supplies and equipment purchased for members, and provided the ownership of stock by others than such producers does not exceed 15 percent of the value of all of its purchases.

The following organizations shall be exempt from taxation under paragraphs (10) and (12). Corporations organized by an association exempt under the provisions of paragraph (10), or members thereof, for the purpose of financing the operations of such members or other producers, such as to provide for the erection of buildings and facilities required in business or for the purchase and installment of machinery and equipment, shall not be denied exemption, will not destroy the exemption. An association of less than 5 percent of the value of the products marketed for nonmembers does not exceed the value of the products marketed for members. Anyone who shares in the profits of a farm association, or is a member of a marketing association, and is entitled to participate in the management of the association, must be regarded as a member of such association within the meaning of section 101 (12).

[Sec. 101. Exemptions from tax on coopera-
and operated in conjunction with such association. Exemption shall not be denied any such corporation because any of its capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 per centum per annum, which income or earnings are derived in whole or in part from the consideration for which the stock was issued, and if substantially all such stock (other than that owned by employees who are entitled and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose):

§ 29.101 (13)–1 Corporations organized to finance crop operations. Corporations organized by farmers' cooperative marketing or purchasing associations, or the members thereof, for the purpose of financing the ordinary crop operations of such membership, if they are not also exempt, also provided, the marketing or purchasing association is exempt under section 101 (12), and the financing corporation is operated in conjunction with the marketing or purchasing association. The provisions of § 29.101 (12)–1 relating to a reserve or surplus and to capital stock shall also apply to corporations coming under this section.

SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS—section 217 (a), Rev. Act 1939; secs. 137 (a), 165 (a), Rev. Act 1942.

The following organizations shall be exempt from taxation under this chapter—

(14) Organizations 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 chapter.

(15) Corporations organized under Act of Congress, if such corporations are instrumentalities of the United States and if, under such Act, as amended and supplemented, such corporations are exempt from Federal income taxes.

(16) Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such associations or their dependents, if (A) no part of their net earnings inures (other than through such payments) to the benefit of any private shareholder or individual, and (B) 85 per centum or more of the income consists of amounts collected from members and amounts contributed to the association by the employer of the member for the sole purpose of making such payments and meeting expenses.

(17) Teachers' retirement fund associations of a purely local character, if (A) no part of their net earnings inures (other than through payments of benefits) to the benefit of any private shareholder or individual, and (B) the income consists solely of amounts levied on members for the purpose of paying taxes (other than public taxes) amounts received from assessments upon the teaching salaries of members, and income in respect of investments.

(18) Religious or apostolic associations or corporations, if such associations or corporations have a common treasury or community treasury, even though such associations or corporations engage in business for the common benefit of the members, but only if the members thereof have no interest whatever (other than any accrued interest which they may retain) in that part of the corporation's property which is owned and operated in conjunction with such associations or corporations for such year. Any amount so included in the gross income of a member shall be treated as a dividend received.

§ 29.101 (13)–1 Religious or apostolic associations or corporations. Religious or apostolic associations or corporations are exempt from taxation under chapter 1 if they have a common treasury or community treasury, even though they engage in business for the common benefit of the members, provided each of the members included, (at the time of filing his return) in his gross income his entire pro rata share, whether accumulated or distributed, of the net income of the association or corporation for the taxable year of the association or corporation ending with or during his taxable year. Any amount so included in the gross income of a member shall be treated as a dividend received.

Every association or corporation claiming exemption as a religious or apostolic association or corporation shall make for each taxable year a return stating specifically the items of its gross income and deductions, and the amount of each deduction, and (A) no part of the net earnings of such corporation shall be for the use of, or in aid of, any private shareholder or individual, and (B) the income consists solely of the common benefit of the members of the association or corporation for their taxable year shall be based upon the net income of the corporation for such year. If the taxable year of any member is different from the taxable year of the association or corporation, the distributive share of the net income of the association or corporation to be included in the gross income of the member for its taxable year shall be based upon the net income of the corporation for the taxable year of the association or corporation ending within the taxable year of the member.

SEC. 102. UNDISTRIBUTED NET INCOME.

The term "undistributed section 102 net income" means the section 103 net income minus the basic surtax credit provided in section 27 (e), but not including the surtax credit under section 26 (e).

The following organizations shall be exempt from taxation under this chapter—

(19) Voluntary employees' beneficiary associations, if (A) no part of their net earnings inures (other than through such payments) to the benefit of any private shareholder or individual, and (B) the income consists solely of amounts collected from members or amounts contributed to the association by the employer of the member for the sole purpose of making such payments and meeting expenses.

(20) Teachers' retirement fund associations of a purely local character, if (A) no part of their net earnings inures (other than through payments of benefits) to the benefit of any private shareholder or individual, and (B) the income consists solely of amounts levied on members for the purpose of paying taxes (other than public taxes) amounts received from assessments upon the teaching salaries of members, and income in respect of investments.

(21) Teachers' retirement fund associations of a purely local character, if (A) no part of their net earnings inures (other than through payments of benefits) to the benefit of any private shareholder or individual, and (B) the income consists solely of amounts collected from members or amounts contributed to the association by the employer of the member for the sole purpose of making such payments and meeting expenses.

(22) Religious or apostolic associations or corporations, if such associations or corporations have a common treasury or community treasury, even though such associations or corporations engage in business for the common benefit of the members, but only if the members thereof have no interest whatever (other than any accrued interest which they may retain) in that part of the corporation's property which is owned and operated in conjunction with such associations or corporations for such year. Any amount so included in the gross income of a member shall be treated as a dividend received.

§ 29.102–1 Taxation of corporation formed or utilized for avoidance of surtax. Section 102 imposes (in addition to other taxes imposed by chapter 1) a graduated income tax or surtax upon a domestic or foreign corporation formed or availed of to avoid the imposition of the individual surtax upon its shareholders or the shareholders of any other corporation through the medium of permitting earnings or profits to accumulate instead of being distributed or paid to shareholders, or any other corporation, through the medium of permitting earnings or profits to accumulate instead of being distributed or paid to shareholders.
tion or use of only one corporation or a chain of corporations. For example, if the capital stock of the M Corporation is held by the N Corporation so that the dividend distributions of the M Corporation would not be returned as income subject to the individual surtax until distributed in turn by the N Corporation to its individual shareholders, nevertheless the surtax imposed by section 102 applies to the M Corporation, if that corporation is formed or availed of for the purpose of avoiding the imposition of the individual surtax upon the individual shareholders of the N Corporation.

A foreign corporation, whether resident or nonresident alien, individually or in whole or in part with respect to distributions of the corporation, which if made would constitute income from sources within the United States, and residents of the United States and therefrom, if any of its shareholders are (1) citizens or residents of the United States and therefore subject to the surtax with respect to distributions of the corporation, or (2) nonresident alien individuals who, by the application of section 211 (c) or section 211 (a), would not be subject to the surtax with respect to distributions of the corporation, the Commissioner will consider the corporation to be a holding or investment company.

For the computation of the surtax see § 29.102-4. § 29.102-3 Unreasonable accumulation of profits. An accumulation of profits (including the undistributed earnings or profits of prior years) is unreasonable if it is not required for the purposes of the business, considering all the circumstances of the case. It is not intended, however, to prevent accumulations of surplus for the reasonable needs of the business if the purpose is not to prevent the imposition of the individual surtax. No attempt is here made to enumerate all the ways in which earnings or profits of a corporation may be accumulated for the reasonable needs of the business. Undistributed income is properly accumulated if retained for working capital needed by the business; or if invested in additional plant reasonably required by the business; or if in accordance with any line of business which it may undertake.

However, a radical change of business when a considerable surplus has been accumulated may afford evidence of a purpose to avoid the surtax. If a 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 although not in legal form the business of the first corporation. Earnings or profits of the first corporation put into the second through the purchase of stock or otherwise granted or contributed to the other corporation are not, however, to be regarded as employment of the income in its business. Investment by a corporation in the stock of another one, the relationship is established, constitute employment of the income in its own business. Investment by a corporation of the income in stock of another one, the relationship is not to itself to be regarded as employment of the income in its business. The business of one corporation may not be regarded as including the business of another unless the other corporation is a mere instrumentality of the first; to establish this it is ordinarily essential that the first corporation own all or substantially all of the stock of the second.

The Commissioner, or any collector upon direction from the Commissioner, may require any corporation to furnish a statement of its accumulated earnings and profits, the name and number of shares held by each of its shareholders, and the amounts that would be payable to each, if the income of the corporation were distributed. (See section 148 (c).)
the "section 102 net income" is first computed. This is accomplished in the case of a domestic corporation by subtracting from the corporate net income (as defined in sections 21 and 204) paid or accrued during the taxable year, not otherwise allowed as a deduction, the amount of the deductions provided in section 23 (a), (f) Federal income, war-profits, and excess-profits taxes (other than the tax imposed by subchapter E of chapter 2 for a taxable year beginning December 31, 1940), paid or accrued during the taxable year, as defined in sections 119 and the regulations thereunder, less statutory deductions) minus the deductions enumerated in (a), (b), and (c) above. In the case of a foreign corporation, whether resident or nonresident, which files no return the "section 102 net income" means the gross income from sources within the United States (gross income from sources within the United States, as defined in section 119 and the regulations thereunder, without the benefit of the deductions enumerated in (a), (b), and (c) above, or to the extent not allowed as a deduction by sections 233. In the case of a taxable year of less than 12 months on account of a change in the accounting period of the corporation, the corporate net income is computed on the basis of the period included in the taxable year, and is not placed on an annual basis under the provisions of section 47 (c).

As defined in section 119 and the regulations thereunder, the "section 102 net income" includes interest upon obligations of the United States and obligations of a corporation organized under Act of Congress, if such corporation is an instrumentality of the United States, except as provided in section 23 (b) (4). The "section 102 net income" does not include interest on obligations of States or Territories of the United States or any political subdivision thereof or of the possessions of the United States. The "undistributed section 102 net income" is computed by subtracting from the "section 102 net income" described above the amount of the basic surplus credit provided in section 27 (b). In computing the basic surplus credit for the purpose of section 102, the credit under section 27 (b) (1) is not to be reduced by the amount of the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations.

SEC. 103. RATES OF TAX ON CITIZENS AND CORPORATIONS OF CERTAIN FOREIGN COUNTRIES [as amended by secs. 101 (b), 102 (c), Rev. Act. 1942]. Whenever the President finds that, under the laws of any foreign country, citizens or corporations of United States are being subjected to discriminatory or extraterritorial taxes, the President shall so proclaim and the rate of tax imposed by sections 13, 14, 16, 18, 201 (a), 204 (a), 204 (d), 207, 211 (a), 211 (d), 231 (a), 232, and 450 shall, for the taxable year during which such proclamation is made, and for each taxable year thereafter, be doubled in the case of each citizen and corporation of such foreign country, but the tax at such double rate shall be considered as imposed by sections 11, 12, 13, 14, 201 (a), 204 (a), 207, 211 (a), 211 (d), 231 (a), 232, and 450, as the case may be. In no case shall this section operate to increase the taxes imposed by such sections (computed without regard to this section) to an amount in excess of 50 per centum of the net income of the taxpayer. Whenever the President finds that the laws of any foreign country with respect to which the President has made a proclamation under the preceding provisions of this section have been modified so that discriminatory and extraterritorial taxes applicable to citizens and corporations of the United States have been removed, he shall so proclaim, and the provisions of this section providing for doubled rates of tax shall not apply to any citizen or corporation of such foreign country with respect to any taxable year beginning after such proclamation is made.

SEC. 104. BANKS AND TRUST COMPANIES [as amended by sec. 192, Rev. Act 1939; sec. 104 (c), Rev. Act. 1939; sec. 1212, (a) Definition. As used in this section the term "bank" means a bank or trust company organized and doing business under the laws of the United States (including laws relating to the District of Columbia), of any State or of any Territory, a substantial part of the business of which consists of receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks under section 11 (k) of the Federal Reserve Act, 38 Stat. 252 (U. S. C., Title 12, § 2460), as amended, or to the extent not specifically excluded or limited by regulation or examination by State, Territorial or Federal authorities having supervision over banking institutions.

(b) Rate of tax. Banks shall be subject to tax under section 13 or section 14 (b), and under section 15.

§ 29.104-1. Tax on banks. A bank, as defined in section 104 (a), subject to the tax imposed by section 13 if it has a normal-tax net income of more than $250,000 (see § 29.13-1), or to the tax provided by section 14 (b) if it has a normal-tax net income of more than $250,000 (see § 29.14-1). Such a bank is also subject to the surtax imposed by section 15 (see § 29.15-1).

Sec. 105. SALE OF OIL OR GAS PROPERTIES. In the case of a bona fide sale of any oil or gas property, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration work done by the taxpayer, the portion of the tax imposed by section 12 attributable to such sale shall not exceed 80 per centum of the selling price of such property or interest.

§ 29.105-1. Surtax on sale of oil or gas properties. If the taxpayer by prospecting and locating claims, or by exploring or discovering undeveloped claims, has demonstrated the principal value of oil or gas property, which prior to his efforts had a relatively minor value, the portion of the surtax imposed by section 12 attributable to a sale of such property or of the taxpayer's interest therein shall not exceed 30 per centum of the selling price of such property or interest.

In determining the portion of the net income attributable to the sale of oil or gas property or interest therein, the taxpayer shall not include the gross income derived from such sale, and to the gross income derived from all other sources, the expenses, losses, and other deductions properly appertaining thereto, and shall apply any refunds, losses, and deductions (which cannot properly be otherwise apportioned) ratably to the gross income from all sources. The gross income derived from the sale of such oil or gas property or interest therein, less the deductions properly appertaining thereto and less its proportion of any general deductions, shall be the amount attributable to such sale. The taxpayer shall submit with his return a statement fully explaining the manner in which such expenses, losses, and deductions are allocated or apportioned.
the gross income of such individual ratably over that part of the period which precedes the date such compensation is received or accrued.

(b) Patent, copyright, etc. For the purposes of this subsection, the term "artistic work or invention" means a literary, musical, or artistic composition of such individual or a patent or copyright covering an invention of or a literary, musical, or artistic composition of such individual covered a period of thirty-six calendar months or more from the beginning to the completion of such composition or invention. If, in the taxable year, the gross income of any individual from a patent or copyright or invention is not less than 80 percent of the gross income in respect of such artistic work or invention in the taxable year, the tax attributable thereto for such taxable year shall not be greater than the aggregate of the taxes attributable to such part had such part been included in the gross income of such individual ratably over that part of the period which precedes the date such compensation is received or accrued. If such individual receives an additional $5,000 in 1946 for such services, he is entitled to the benefits of section 107 (a); and the tax attributable to the $10,000 received in 1940 and included in such individual's gross income for such year shall not be greater than the tax attributable to such amount, had it been received ratably over the calendar year basis. If such individual receives an additional $5,000 in 1946 for such services, the tax attributable to the $10,000 received in 1940 and included in such individual’s gross income for such year shall not exceed the tax attributable to such amount. If such individual receives an additional $5,000 in 1946 for such services, he is entitled to the benefits of section 107 (a) for the reason that he does not receive in one taxable year at least 80 percent of the total compensation for such services.

Thus, for example, if an individual who renders personal services covering a period of thirty-six calendar months or more (from the beginning to the completion of such services) is entitled to the benefits of section 107 (a); and the tax attributable to such part had such part been included in the gross income of such individual ratably over that part of the period which precedes the date such compensation is received or accrued, as if the compensation had been received or accrued in equal portions in each of such calendar months. For what constitutes a taxable year, see section 46 (a). The amount of such compensation which is included in the gross income of any individual for any taxable year is the difference between the tax for such year computed with the inclusion of an allowable portion of such compensation in gross income and the tax for such year computed without including any part of such compensation in gross income. The portion of the compensation allocable to each taxable year for an amount equal to the entire amount of such compensation received or accrued in the current taxable year, divided by the entire number of calendar months included within the part of the period of service which precedes the date such compensation is received or accrued, and multiplied by the number of such calendar months falling within the particular taxable year.

The tax for the current taxable year shall be the tax for such year computed without including the compensation for personal services in gross income, plus (1) the amount of compensation attributable to such compensation (computed in accordance with the second preceding paragraph) or (2) the sum of the taxes attributable to such compensation had it been received ratably over the calendar year basis, whichever is the smaller.

The method of allocating compensation for personal services to the taxable years in which falls any of the calendar months included within the part of the period of service which precedes the date such compensation is received or accrued. For the purposes of determining whether the aggregate of the taxes attributable to the $5,000 compensation received in each of such calendar months included within the part of the period of service which precedes the date such compensation is received or accrued in equal portions in each of the calendar months included within the period of service which precedes the date such compensation is received or accrued is greater than the tax attributable to such compensation for the taxable year included within the part of the period of service which precedes the date such compensation is received or accrued, the date the compensation is received or accrued is considered as the month in which such compensation is received or accrued.

Example (1). On January 1, 1942, A, an individual, who makes his income tax returns on the calendar year basis, receives $10,000 for personal services rendered by him as an individual. For the taxable year ending June 30, 1942, the entire compensation for the performance of personal services covering a 49-month period beginning on June 1, 1941, and ending on September 30, 1942. For the purposes of determining whether the aggregate of the taxes attributable to the $10,000 compensation received in each of such calendar months included within the period of service which precedes the date such compensation is received or accrued in equal portions in each of the calendar months included within the period of service which precedes the date such compensation is received or accrued is greater than the tax attributable to such compensation for the taxable year included within the period of service which precedes the date such compensation is received or accrued, the date the compensation is received or accrued is considered as the month in which such compensation is received or accrued.

Example (2). Assume the same facts as in example (1) except that A makes his income tax returns on the fiscal year basis. The taxable year ending June 30, 1942, the entire compensation for the performance of personal services covering a 49-month period beginning on January 1, 1941, and ending on December 31, 1941. For the purposes of determining whether the aggregate of the taxes attributable to the $10,000 compensation received in each of such calendar months included within the period of service which precedes the date such compensation is received or accrued is greater than the tax attributable to such compensation for the taxable year included within the period of service which precedes the date such compensation is received or accrued, the date the compensation is received or accrued is considered as the month in which such compensation is received or accrued.

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§ 29.107-1 Personal services. Section 107 (a) provides that if at least 80 percent of the total compensation for personal services covering a period of 36 calendar months or more (from the beginning to the completion of such services) is rendered in one taxable year, an allowable portion of such compensation (paid by an individual or a partnership, then the tax attributable to any part of such amount which is included in the gross income of any individual shall not be greater than the aggregate of the taxes attributable to such part had such part been included in the gross income of such individual ratably over that part of the period which precedes the date such compensation is received or accrued. Thus, for example, if an individual who renders personal services covering a period of 36 calendar months or more (from the beginning to the completion of such services) is entitled to the benefits of section 107 (a); and the tax attributable to such part had such part been included in the gross income of such individual ratably over that part of the period which precedes the date such compensation is received or accrued, as if the compensation had been received or accrued in equal portions in each of such calendar months. For what constitutes a taxable year, see section 46 (a). The amount of such compensation which is included in the gross income of any individual for any taxable year is the difference between the tax for such year computed with the inclusion of an allowable portion of such compensation in gross income and the tax for such taxable year computed without including any part of such compensation in gross income. The portion of the compensation allocable to each taxable year for an amount equal to the entire amount of such compensation received or accrued in the current taxable year, divided by the entire number of calendar months included within the part of the period of service which precedes the date such compensation is received or accrued, and multiplied by the number of such calendar months falling within the particular taxable year.

The tax for the current taxable year shall be the tax for such year computed without including the compensation for personal services in gross income, plus (1) the amount of compensation attributable to such compensation (computed in accordance with the second preceding paragraph) or (2) the sum of the taxes attributable to such compensation had it been received ratably over the calendar year basis, whichever is the smaller.

The method of allocating compensation for personal services to the taxable years in which falls any of the calendar months included within the part of the period of service which precedes the date such compensation is received or accrued. For the purposes of determining whether the aggregate of the taxes attributable to the $10,000 compensation received in each of such calendar months included within the period of service which precedes the date such compensation is received or accrued is greater than the tax attributable to such compensation for the taxable year included within the period of service which precedes the date such compensation is received or accrued, the date the compensation is received or accrued is considered as the month in which such compensation is received or accrued.

Example (1). On January 1, 1942, A, an individual, who makes his income tax returns on the calendar year basis, receives $10,000 for personal services rendered by him as an individual. For the taxable year ending June 30, 1942, the entire compensation for the performance of personal services covering a 49-month period beginning on June 1, 1941, and ending on September 30, 1942. For the purposes of determining whether the aggregate of the taxes attributable to the $10,000 compensation received in each of such calendar months included within the period of service which precedes the date such compensation is received or accrued is greater than the tax attributable to such compensation for the taxable year included within the period of service which precedes the date such compensation is received or accrued, the date the compensation is received or accrued is considered as the month in which such compensation is received or accrued.

Example (2). Assume the same facts as in example (1) except that A makes his income tax returns on the fiscal year basis. The taxable year ending June 30, 1942, the entire compensation for the performance of personal services covering a 49-month period beginning on January 1, 1941, and ending on December 31, 1941. For the purposes of determining whether the aggregate of the taxes attributable to the $10,000 compensation received in each of such calendar months included within the period of service which precedes the date such compensation is received or accrued is greater than the tax attributable to such compensation for the taxable year included within the period of service which precedes the date such compensation is received or accrued, the date the compensation is received or accrued is considered as the month in which such compensation is received or accrued.
Example (3). Assume the same facts as in Example (1). A receives $40,000 on February 1, 1942 (before completion of the period of service) and completes the same on August 1, 1942. The 32 calendar months included within the period of service which precedes the date the compensation is received are as follows: $12,000 to 1941, $12,000 to 1942 (the current taxable year). The amount of $12,000 previously allocated to each of such years in his return for the calendar year 1941.

§ 29.107-2 Artistic work or invention.

Section 107 (b) provides that the gross income of an individual from an artistic work or invention received or accrued during a period of 36 calendar months or more (beginning on the date the period of work which preceded the close of the current taxable year, and multiplied by the number of such calendar months) is taxable as a gain from the sale or exchange of a capital asset held for more than six months. That part of the gross income from such artistic work or invention which is taxable as a gain from the sale or exchange of a capital asset held for more than six months is excluded from the gross income of the artistic work or invention. The tax attributable to such gross income in the taxable year shall not be greater than the aggregate of the taxes attributable thereto had it been received ratably over (1) the part of the period of the work which precedes the close of the taxable year, dividends, or payments of $12,000 to 1941, and $40,000 on August 1, 1942. Thus $12,000 is allocated to 1941, and $24,000 to 1942 (the current taxable year). If, therefore, the total compensation for such services is $74,000, of which $44,000 is paid to A on March 1, 1942, and $30,000 is paid to B on January 10, 1943, and $10,000 to each of the 60 calendar months, allocations may be made to only a part of the period of service which precedes the close of the current taxable year, divided by the entire number of the calendar months included within the part of the period of work which precedes the close of the current taxable year, and multiplied by the number of such calendar months included within the part of the period of work which precedes the close of the current taxable year, and multiplied by the number of such calendar months included within the part of the period of work which precedes the close of the current taxable year.

The tax for the current taxable year shall be the tax for such year computed without including in gross income the gross income from the artistic work or invention, plus whichever of the following is the smaller: (i) the amount of tax for such taxable year attributable to the gross income from the artistic work or invention (computed in accordance with the preceding paragraph) or (2) the sum of the taxes attributable to the gross income from the artistic work or invention which has been received or accrued in the current taxable year, and computed in according with the preceding paragraph).

The method of allocating the gross income from the artistic work or invention to the taxable years in which falls any of the calendar months included within the period of work which precedes the close of the current taxable year may be illustrated by the following example:

Example (1). On October 1, 1942, A, an individual, who makes his returns on a calendar year basis and on the basis of cash receipts and disbursements, receives $12,000 as full payment for a musical composition, the work on which was commenced by A on May 1, 1939, and completed on January 20, 1943. Although the entire work covers 36 calendar months, allocations may be made to only the last 26 calendar months included within the part of the period of work which precedes the close of 1942 (the current taxable year). Therefore, $1,000 ($12,000 divided by 26) must be allocated to each of the 26 calendar months preceding January 1, 1943. Accordingly, $12,000 is allocated to January 1943, $12,000 to February 1943, and $8,000 to 1942 (the current taxable year).

Example (2). Assume the same facts as in example (1) except that the period of work was commenced by A on May 1, 1940, and completed on September 1, 1944. Although the period of work covers 32 calendar months, allocations may be made to only the 28 calendar months which are included within the part of the period of work which precedes the close of 1942 (the current taxable year). Therefore, $8,000 ($32,000 divided by 18) must be allocated to each of 18 calendar months preceding January 1, 1943. Accordingly, $12,000 is allocated to January 1943, $12,000 to February 1943, and $12,000 to 1942 (the current taxable year).

The principles set forth in the last paragraph of § 29.107-1, relating to the manner of allocating compensation for personal services to a particular calendar month where an allocation for other
such services has previously been made to such month, are also applicable with respect to allocations under section 107 (b).

Sec. 108 (Added by sec. 160 (a), Rev. Act 1945—not applicable to taxable years beginning after December 31, 1941).

Sec. 109, Western Hemisphere trade corporations [as added by sec. 141, Rev. Act 1945].

For the purposes of this chapter, the term “Western Hemisphere trade corporation” means a domestic corporation all of whose business is done in any country or countries in North, Central, or South America, or the West Indies, or in Newfoundland and which satisfies the following conditions:

(a) 15 percent or more of the gross income of such domestic corporation for the three-year period immediately preceding the close of the taxable year (or for such part of such period during which the corporation was in existence) was derived from sources other than sources within the United States; and

(b) If 90 percent or more of its gross income for such period or such part thereof was derived from the active conduct of a trade or business.

§ 29.109-1 Western hemisphere trade corporations. Under the provisions of section 15 a domestic corporation qualifying as a Western Hemisphere trade corporation is exempt from the surtax imposed upon corporations generally by section 15. To so qualify, the following tests must be met:

(a) Its entire business must be carried on within the geographical limits of North, Central, or South America, or in the West Indies, or in Newfoundland; and

(b) 95 percent or more of its gross income for the 3-year period immediately preceding the close of the taxable year (or for such part of such period during which the corporation was in existence) must be derived from sources without the United States.

A corporation which claims exemption as a Western Hemisphere trade corporation shall attach to its income tax return a statement showing that its entire business is done in one or more of the designated countries, and for the 3-year period immediately preceding the close of the taxable year (or for such part thereof during which the corporation was in existence) (1) its total gross income from all sources, (2) the amount thereof derived from the active conduct of a trade or business, (3) a description of such trade or business and the facts upon which the corporation relies to establish that such trade or business was actively conducted by it, and (4) the amount of its gross income, if any, from sources within the United States shall be determined as provided in section 119 and the regulations prescribed thereunder.

COMPUTATION OF NET INCOME SEE SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN ON LOS.

(a) Computation of gain on loss. The gain from the sale of the other disposition of property shall be the excess of the amount realized thereon, from the adjusted basis provided in section 113 (b) (1) (A), over the adjusted basis provided in section 113 (b) (1) (D), the loss shall be the excess of the adjusted basis provided in such section for determining losses over the amount thereof the Internal Revenue Code regards as income or realization of gain or loss from the sale or other disposition of property is prescribed in section 113 (b) (1) (A) and (D).

(b) Amount realized. The amount realized from the sale of the other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(c) Recognition of gain or loss. In the case of corporations, nothing in this section is to prevent the recognition of gain or loss merely because, in its return for the calendar year in which such payment is received, the corporation would report such gain or loss.

§ 29.111-1 Computation of gain or loss. Except as otherwise provided, the Internal Revenue Code regards as income or as loss sustained, the gain or loss realized from the property in cash, or from the exchange of property for other property differing materially either in kind or in extent. The amount realized from a sale or other disposition of property in money received plus the fair market value of any property which is received. The fair market value of property is a question of fact, but only in rare and extraordinary cases will property be recognized at the time of the exchange.

A corporation which claims exemption as a Western Hemisphere trade corporation shall attach to its income tax return a statement showing that its entire business is done in one or more of the designated countries, and for the 3-year period immediately preceding the close of the taxable year (or for such part of such period during which the corporation was in existence) must be derived from sources without the United States; and

(c) 90 percent or more of its gross income for such period or such part thereof was derived from the active conduct of a trade or business.

§ 29.109-1 Western hemisphere trade corporations. Under the provisions of section 15 a domestic corporation qualifying as a Western Hemisphere trade corporation is exempt from the surtax imposed upon corporations generally by section 15. To so qualify, the following tests must be met:

(a) Its entire business must be carried on within the geographical limits of North, Central, or South America, or in the West Indies, or in Newfoundland; and

(b) 95 percent or more of its gross income for the 3-year period immediately preceding the close of the taxable year (or for such part of such period during which the corporation was in existence) must be derived from sources without the United States.

A corporation which claims exemption as a Western Hemisphere trade corporation shall attach to its income tax return a statement showing that its entire business is done in one or more of the designated countries, and for the 3-year period immediately preceding the close of the taxable year (or for such part thereof during which the corporation was in existence) (1) its total gross income from all sources, (2) the amount thereof derived from the active conduct of a trade or business, (3) a description of such trade or business and the facts upon which the corporation relies to establish that such trade or business was actively conducted by it, and (4) the amount of its gross income, if any, from sources within the United States shall be determined as provided in section 119 and the regulations prescribed thereunder.
In such a case gain is recognized to the extent of the boot (see section 112 (c) and (d)), but no loss of any kind is recognized (see section 112 (a) and (b)).

The exceptions from the general rule requiring the recognition of all gains and losses, like other exceptions from a rule of taxation of general and uniform application, are intended to do no more than either extend beyond the words or the underlying assumptions and purposes of the exception. Nonrecognition is accorded in the Internal Revenue Code only if the transaction is one which satisfies both (1) the specific description in the Code of an excepted exchange, and (2) the underlying purpose for which such exchange is excepted from the general rule. The exchange must be ger- mane to, and a necessary incident of, the investment or enterprise in hand. The relationship of the exchange to the venture must be shown. As elsewhere, the taxpayer claiming the benefit of the exception must show himself within the exception.

To constitute an exchange within the meaning of section 112 (b) (1) to (5), inclusive, the transaction must be a reciprocal transfer of property, as distinguished from a transfer of property for a money consideration only.

See section 112 (b) (6) with respect to nonrecognition of gain or loss upon the receipt of property distributed in complete liquidation of a corporation under certain specifically described circum- stances. See sections 112 (b) (8) and 371 with respect to nonrecognition of gain or loss upon exchanges and dis- tributions made in obedience to orders of the Securities and Exchange Commission. See section 510 of the Merchant Marine Act of 1936, as added by section 7 of the Act of August 6, 1938 (53 Stat. 1183), with respect to nonrecognition of gain in case of the transfer of an obsolescent vessel to the Maritime Commission under the provisions of such section.

§ 29.112 (a)–2 Use of term “assump- tion of liabilities.” When used in the regulations prescribed under sections 112 and 113, the terms “assumption of liabilities,” “liabilities assumed,” or similar expressions include, in addition to cases where personal liabilities of the taxpayer are assumed by another party to the exchange, cases (1) where property of the taxpayer is acquired by another party to the exchange subject to a liabil- ity, whether or not the taxpayer was himself personally liable, and (2) where, though the property transferred was held by the taxpayer merely subject to a liability, the liability is assumed by another party to the exchange.

[Sec. 112. RECOGNITION OF GAIN OR LOSS—as amended by sec. 215 (a) (b), c), Rev. Act 1936; secs. 142 (a), 151 (d) (e), Rev. Act 1943.] (b) Exchange solely in kind—(1) Property held for productive use or investment. No gain or loss shall be recognized if property held for productive use or for business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial in- terest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind held for productive use in trade or business or for investment.

§ 29.112 (b) (1)–1 Property held for productive use in trade or business or for investment. As used in section 112 (b) (1), the words “like kind” have reference to the nature or character of the property and not to its grade or quality. One kind or class of property may not, under the expression “like kind” of property of a different kind or class. The fact that any real estate involved is improved or unimproved is not material, for such facts relate only to the grade or quality of the property and not to its kind or class. Unproductive real estate held by one other than dealer for future use or future realization of the increment in value is held for investment and not primarily for sale.

No gain or loss is recognized if (1) a taxpayer exchanges property held for productive use in his trade or business, together with cash, for other property of the same kind, such as (a) a truck for a new truck or a passenger automobile for a new passenger automobile to be used for a like purpose, or (b) a taxpayer who is not a dealer in real estate exchanges a house for a ranch or farm, or a leasehold of a fee with 30 years or more to run for real estate, or improved real estate for unim- proved real estate, or (3) a taxpayer exchanges investment property and cash for investment property of a like kind.

A transfer is not within the provisions of section 112 (b) (1) if as part of the consideration the other party to the exchange assumes a liability of the tax- payer, but such transfer, if otherwise qualified, will be within the provisions of section 112 (c).

Gain or loss is recognized if a taxpayer exchanges (1) Treasury bonds maturing October 15, 1945, for Treasury bonds maturing June 15, 1963, or (2) a real estate mortgage for bonds of the Home Owners’ Loan Corporation.

[Sec. 112. RECOGNITION OF GAIN OR LOSS—as amended by sec. 213 (a) (b), (c), Rev. Act 1936; secs. 142 (a), 151 (d) (e), Rev. Act 1943.] (b) Exchanges solely in kind—(1) Stock for stock of same corporation. No gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

§ 29.112 (b) (2)–1 Stock for stock of the same corporation. The transaction, without the recognition of gain or loss, of common stock for common stock, or of preferred stock for preferred stock, in the same corporation is not limited to a transfer between a stockholder and the corporation; it includes an exchange between two individual stockholders. However, the provisions of section 112 (b) (2) do not apply if stock is ex- changed for bonds, or preferred stock is exchanged for common stock, or common stock is exchanged for preferred stock, or common stock in one corporation is exchanged for common stock in another corporation.

A transfer is not within the provisions of section 112 (b) (2) if for the purpose of considering the other party to the ex- change assumes a liability of the taxpayer, but such transfer, if otherwise qualified, will be within the provisions of section 112 (c).

[Sec. 112. RECOGNITION OF GAIN ON LOSS—as amended by sec. 213 (a) (b), (c), Rev. Act 1936; secs. 142 (a), 151 (d) (e), Rev. Act 1943.] (b) Exchanges solely in kind—(3) Stock for stock on reorganization. No gain or loss shall be recognized if stock or securities in a corporation in which a party to the organization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) Same; gain of corporation. No gain or loss shall be recognized if a corporation a party to a recognition exchanges prop- erty, in pursuance of the plan of reorgan- ization, solely for stock or securities in another corporation a party to the reorgan- ization.

(5) Transfer to corporation controlled by transferor. If property is transferred to a corpora- tion by one or more persons solely in ex- change for stock or securities in such corpora- tion, and immediately after the exchange such person or persons are in control of the corporation and in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property exchanged. Where the transferor assumes a liability of a transferor, or where the property of a transferor is transferred subject to a liability, then for the purpose of determining whether the amount of stock or securities received by each of the transfers is in the proportion required by this paragraph, the amount of such liability (if under subsection (k) it is not to be con- sidered as “other property or money”) shall be considered as stock or securities received by such transferor.

§ 29.112 (b) (5)–1 Transfer of prop- erty to corporation controlled by transferor. As used in section 112 (b) (5), the phrase “one or more persons” includes individuals, trusts or estates, partnerships and corporations (see section 3979) and to be in “control” of the transferor corporation such person or persons must own immediately after the transfer stock possessing at least 80 per- cent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of such corporation. (See section 112 (h).) The phrase “immediately after the exchange” does not necessarily re- quire simultaneous exchanges by two or more persons, but comprehends a situation in which the rights of the parties have been previously defined and the execution of the exchange is not completed with an expedition consistent with or- derly procedure.

Example (1). A owns certain real estate which cost him $50,000 in 1920, but which is now appraised at $1,200,000 in 1942. He transfers this property to the M. Cor- poration, a newly formed company, for all the latter’s capital stock. No gain or loss is recognized on the transaction.
Example (2). C owns a patent right worth $250,000 and D owns a manufacturing plant worth $200,000. C and D organize the X Corporation with an authorized capital stock of $1,000,000. C transfers his patent right to the X Corporation for $750,000 and D transfers his plant to the new corporation for $250,000 of its stock. No gain or loss is recognized by C or D on this transaction.

Example (3). B owns certain real estate which cost him $500,000 in 1929, but which has a fair market value of $200,000 in 1942. He transfers the property to the X Corporation in 1942 for 78 percent of each class of stock of the corporation, the remaining 22 percent of the corporation's stock being issued by the corporation in 1933 to other persons for cash. It realizes a taxable gain of $100,000 on this transaction. (See section 112 (b).)

§ 29.112 (b) (5)–2 Treatment of assumptions of liabilities—(a) Recognition of gain. For the effect upon the recognition of gain of an assumption of liabilities in a transfer described in section 112 (b) (2), see section 112 (c) and the regulations prescribed thereunder.

(b) Computation of proportionate interests required by section 112 (b) (5). In any case where an assumption of liabilities is not to be treated as "other property or money" under section 112 (c), the liabilities so assumed are, for the purpose of determining whether the stock or securities received by the transferee are substantially proportionate to their interests in the property transferred, as required by section 112 (b) (5), to be treated as stock or securities received by the transferor whose indebtedness is assumed. The application of this paragraph may be illustrated by the following example:

Example. A and B, individuals, each owns property with a fair market value of $100,000 on July 1, 1942. There is a purchase money mortgage on A's property of $50,000. On July 1, 1942, A and B organize the X Corporation, to which they transfer the property above described for the entire capital stock of the X Corporation and the assumption by the X Corporation of A's mortgage on his property.

The X Corporation's capital stock is divided as follows: $50,000 to A and $100,000 to B. Nevertheless, for the purpose of determining whether the "other property or money" received by the X Corporation is received in complete cancellation or redemption of all the property of the transferor whose indebtedness is assumed, it is to be deemed that A and B have received stock or securities substantially in proportion to their interests in the properties transferred, as required by section 112 (b) (5). A is deemed to have received stock or securities to the extent of $100,000, since his $50,000 purchase money mortgage, assumed by the X Corporation, is also to be treated as stock or securities received by him. Accordingly, under the facts as stated, the provisions required by section 112 (b) (5) exist.

§ 29.112 (b) (5)–3 Records to be kept and information to be filed. Every person who receives the stock or securities of a controlled corporation for property under section 112 (b) (5) shall file with his income tax return for the taxable year in which the exchange takes place a complete statement of all facts pertinent to the nonrecognition of gain or loss upon such exchange:

(a) A description of the property transferred, or of his interest in such property, together with a statement of the cost or other basis thereof, adjusted to the date of the transfer and;

(b) A statement of the amount of stock or securities and other property or money received in the exchange, including any liabilities of the taxpayer assumed by the controlled corporation, the amount of each kind of stock or securities and other property received shall be set forth at its fair market value at the date of the exchange.

Every such controlled corporation shall file with its income tax return for the taxable year in which the exchange takes place:

(1) A full description of all property received from the transferee, together with the number of shares of all classes of stock (except stock and securities of such controlled corporation) and the amount of such other property or money received, in order to facilitate the determination of gain or loss from a subsequent disposition of such stock or securities received by the taxpayer.

(2) A statement of the amount of stock or securities and other property or money which passed to the transferee in the transaction (including any liabilities assumed by such controlled corporation), together with a full statement of all the amount of the issued and outstanding stock and securities of such controlled corporation immediately after the exchange and of the ownership of each class of such securities and other property of such controlled corporation immediately after the exchange (showing as to each class the number of shares and percentage owned and the voting power of each share of stock or of each unit of other property).

Permanently records in substantial form shall be kept by every taxpayer who participates in a tax-free exchange under section 112 (b) (5) showing clearly the amount of the gain or loss recognized and the fair market value of the property received, or money received, in order to facilitate the determination of gain or loss from a subsequent disposition of such stock or securities received by the taxpayer.

[SEC. 112. RECOGNITION OF GAIN OR LOSS—AMENDED BY SEC. 218 (A) (B) (C), REV. ACT. 1918; SEC. 142 (5), 151 (4), (D) (E), REV. ACT. 1912.]

§ 29.112 (b) (6)–1 Distributions in liquidation of subsidiary corporation. (a) General. Under the general rule prescribed by section 115 (c) for the treatment of distributions in liquidation of a corporation, amounts received by one corporation in complete liquidation of another corporation, not attributable to shares owned by the taxpayer, and any income from such amounts is to be determined as provided in section 111. The scope of this treatment is governed by the term "amounts distributed in complete liquidation of a subsidiary corporation" as used in section 115 (c), section 112 (b) (6) excepts from the general rule property received, under certain specifically described circumstances, "in liquidation of a corporation in complete liquidation of another corporation," as used in section 115 (c).

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other corporation and provides for the nonrecognition of gain or loss in these cases which meet the statutory requirements. Section 112 (i) places a limitation on the application of section 112 (a) (6) in the case of foreign corporations. See § 29.113 (a) (15)–1 for the basis for determining gain or loss from the subsequent sale of property received upon complete liquidations such as described in this section.

(b) Requirements for nonrecognition of gain or loss. The nonrecognition of gain or loss is limited to the receipt of such property by a corporation which possesses, at the time of the distribution, the actual owner of stock (in the liquidating corporation) possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 percent of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends). The Internal Revenue Code expressly requires that the recipient corporation must have been the owner of the specified amount of such stock on the date of the adoption of the plan of liquidation and have continued so to be at all times until the receipt of the property. The Code also expressly requires that the recipient corporation shall not at any time, on or after the date of the adoption of the plan and until the receipt of the property, be the owner of a greater percentage of any class of stock than the percentage of such class owned at the time of the receipt of the property. If the recipient corporation does not continue qualified with respect to ownership of stock of the liquidating corporation and if the failure to continue qualified occurs at any time prior to the completion of the transfer of all the property, the provisions for the nonrecognition of gain or loss do not apply to any distribution received under the plan.

The provisions of section 112 (b) (6) do not apply to any liquidation if any distribution in pursuance thereof has been made before the first day of the first taxable year of the recipient corporation beginning after December 31, 1925.

To constitute a distribution in complete liquidation within the meaning of section 112 (b) (6), the distribution must be (1) made by the liquidating corporation in complete cancellation or redemption of all of its stock in complete liquidation and have continued so to be at all times until the receipt of the property. It is essential that a status of liquidation be completed prior to the actual dissolution of the liquidating corporation and the transfer of all property and assets of the liquidating corporation and the receiver or trustees in liquidation are finally divested of all the property (both tangible and intangible). (See § 29.23 (a)–29.23 (b).)

§ 29.112 (b) (2) Liquidations completed within one taxable year. If in a liquidation completed within one taxable year, pursuant to a plan of complete liquidation, distributions in complete liquidation are received by a corporation which possesses at the time of such stock in liquidating corporation and which continues qualified with respect to the ownership of such stock until the transfer of all the property within such year is completed (see § 29.112 (b) (6)–1), then no gain or loss shall be recognized with respect to the distributions received by the recipient corporation. In such case no waiver or bond is required under section 112 (b) (1).

§ 29.112 (b) (6)–3 Liquidations covering more than one taxable year. If the plan of liquidation is consummated by a series of distributions covering a period of more than one taxable year, the nonrecognition of gain or loss with respect to the distributions in liquidation shall, in addition to the requirements of § 29.112 (b) (6)–1, be subject to the following requirements:

(a) In order for the distribution in liquidation to be brought within the exception provided in section 112 (b) (6) to the general rule for computing gain or loss with respect to amounts received in liquidation of a corporation, the entire property of the corporation shall be transferred in accordance with a plan of liquidation, which plan shall include a statement showing the amount of such property which the transfer of the property of the liquidating corporation to the recipient corporation is to be completed within a period not exceeding three years from the close of the taxable year during which is made the first of the series of distributions under the plan.

(b) For each of the taxable years which falls wholly or partly within the period of liquidation, the recipient corporation shall, at the time of filing its return, file with the collector for the district the Commissioner a waiver of the statute of limitations on assessment. The waiver shall be executed on such form as may be prescribed by the Commissioner and shall extend the period for assessment of all income and profits taxes for each such year to a date not earlier than one year after the last date of the period for assessment of such taxes for the taxable year within which the transfer of the property of the liquidating corporation to the controlling corporation may be completed in accordance with section 112 (b) (6). Such waiver shall also contain such a statement with respect to assessment as may be considered by the Commissioner to be necessary to insure the assessment and collection of the correct tax liability for each year within the period of liquidation.

(c) For each of the taxable years which falls wholly or partly within the period of liquidation, the recipient corporation shall file a bond, the amount of which shall be fixed by the Commissioner. The bond shall contain all terms specified by the Commissioner, including provisions with respect to the provisions of sections 112 (b) (4) and 115 (a) (15) over such taxes computed with regard to such provisions, regardless of whether such excess may or may not be made the subject of a notice of deficiency under section 272 and regardless of whether it may or may not
be assessed. Any bond required under section 112 (b) (6) shall have such surety or sureties as the Commissioner may require. However, see section 126 of the Revenue Act of 1926, as amended, providing that where a bond is required by law or regulations, in lieu of surety or sureties there may be deposited bonds or notes issued by the United States or any State or any political subdivision thereof. Only surety companies holding certificates of authority from the Secretary as acceptable sureties on Federal bonds will be approved as sureties. The bonds shall be nonnegotiable and evidence the agreement of the Commissioner, the taxpayer, and the surety or the depositary may each have a copy.

Pending the completion of the liquidation, if there is a compliance with paragraphs (a), (b), and (c) of this section and § 29.112 (b) (6) 1 with respect to the nonrecognition of gain or loss, the income and profits tax liability of the recipient corporation for each of the years covered in whole or in part by the liquidation shall be determined without the recognition of any gain or loss on account of the distributions in liquidation. In such determination, the basis of the property or properties received by the recipient corporation shall be determined in accordance with section 112 (a) (15) and the amount of additional tax due upon such recomputation shall be promptly paid.

§ 29.112 (b) (6) 4 Distributions in liquidation as affecting minority interests. Upon the liquidation of a corporation in pursuance of a plan of complete liquidation, a gain or loss to the minority shareholders shall be determined without regard to the provisions of section 112 (b) (6) or section 112 (a) (15) and the amount of additional tax due upon such recomputation shall be promptly paid.

§ 29.112 (b) (6) 5 Records to be kept and information to be filed with return. (a) Permanent records in substantial form shall be kept by every corporation receiving distributions in complete liquidation within the exception provided in section 112 (b) (6) showing the information required by this section to be submitted with its return. The plan of liquidation must be adopted by each of the corporations parties thereto; and the adoption must be shown by the acts of its duly constituted responsible officers, and appear upon the official records of each such corporation.

(b) Year in which the liquidation occurs, or, if the plan of liquidation provides for a series of distributions over a period of more than one year, for each taxable year in which a distribution is received under the plan, the recipient corporation shall keep a complete statement of all facts pertinent to the nonrecognition of gain or loss, including:

1. A certified copy of the plan for complete liquidation, and of the resolutions under which the plan was adopted and the liquidation was authorized, together with a statement under oath showing in detail all transactions incident to the plan;

2. A list of all properties received upon the distribution, showing the cost or other basis of such properties to the liquidating corporation at the date of distribution and the fair market value of such properties on the date distributed.

3. A statement as to its ownership of all classes of stock of the liquidating corporation (showing as to each class the number of shares and percentage owned and the voting power of each share) as of the date of the adoption of the plan of liquidation, and at all times since, to and including the date of the distribution in liquidation, and the cost or other basis of such stock.

Section 112 (b) (9) describes the transfer resulting in a gain and has no application if the transfer thereto described results in a gain.

[Sec. 112. RECOGNITION OF GAIN OR LOSS—amended by sec. 213 (a) (b) (e), Rev. Act 1939; sec. 142 (a), 151 (d) (e), Rev. Act 1943.]

1. Gain from exchanges not solely in kind.

(a) If an exchange would be within the provisions of subsection (b) (5), (6), or (7) of this section if it were for property in exchange, the property received in exchange must not be property permitted by such paragraphs to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount equal to the sum of such money and the fair market value of such other property.

(b) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the liquidated earnings and profits of the corporation accumulated after February 23, 1932. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

§ 29.112 (c) 1 Receipt of other property or money in tax-free exchange not connected with corporate reorganization, if in any transaction in which (a) property held for investment or productive use in trade or business is exchanged for property of like kind to be held for productive use or for investment; or (b) common stock is exchanged for common stock, or preferred stock, or preferred stock in the same corporation and not in connection with a corporate reorganization; or (c) property is transferred by one or more persons to a corporation for its stock or securities, within the meaning of section 112 (b) (5), there is received by the taxpayer other property (in addition to property permitted to be received without recognition of gain) or money, then:

1. The gain, if any, to the taxpayer will be recognized in an amount not in excess of the sum of the money and the fair market value of the other property, but

2. The loss, if any, to the taxpayer from such an exchange is not to be recognized to any extent (See section 112 (e) 2).

Example. A, who is not a dealer in real estate, in 1926 exchanges real estate which he purchased (for investment) in 1921 for $6,000, for other real estate (to be held for productive use in trade or business) which has a fair market value of $6,000, and he receives in addition $2,000 in cash. The gain from the transaction is $6,000, but is recognized only to the extent of the cash received of $2,000.

Consideration received in the form of an assumption of liabilities is to be treated as "other property or money" for the purposes of so much of section 112 (c) as relates to section 112 (b) (1), (2), and (3). As to the proper treatment of such consideration for so much of section 112 (c) as relates to section 112 (b) (5), see section 112 (d) and § 29.112 (c) 1.
See section 113 (a) (6) for the basis for determining the gain or loss from the subsequent sale of the property received in exchanges such as described in this section.

As to the receipt of other property or money on an exchange of stock or securities in connection with a reorganization, and as to distributions in pursuance of a plan of reorganization which have the effect of a taxable dividend, see §29.112 (g)–4.

§29.112. Recognition of gain or loss—As amended by sec. 213 (a) (b) (c), Rev. Act 1939; sec. 142 (a), 161 (d) (g), Rev. Act 1942.

(d) Gain of corporation. If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then:

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in amount not in excess of the sum of the fair market value of any other property so received, which is not so distributed.

(e) Loss from exchanges not solely in kind.

If an exchange would be within the provisions of subsection (b) (1) to (5), inclusive, of this section, and if the corporation receiving the property in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or other property or money, then no loss from the exchange shall be recognized.

§29.112 (c)–1 Nonrecognition of loss.

The Internal Revenue Code provides that in no event shall a loss be recognized from a tax-free exchange of property under section 112 (b) (1) to (5), inclusive, notwithstanding the fact that there is received in the exchange other property or money which permitted to be received without recognition of gain or loss.

As to the basis of the property received in an exchange for the purpose of determining gain or loss from the subsequent sale thereof, see section 113 (a) (6).

As to the nonrecognition of loss upon the receipt of property by one corporation in complete liquidation of another corporation under certain specifically described circumstances, see section 112 (b) (6).

§29.112 (f)–1 Reinvestment of proceeds of involuntary conversions. Upon the involuntary conversion of property described in section 112 (f), no gain is recognized if the provisions of that section are complied with. If any part of the money received as a result of such conversion is not expended, the gain, if any, shall be recognized to the extent of the money which is not so expended. The amount of the money received in one or more taxable years and regardless of whether or not the money which is not so expended constitutes gain.

§29.112 (f)–2 Replacement funds. In any case where the taxpayer elects to replace or restore the converted property but it is not practicable to do so immediately (for example, because of the taxpayer's inability to obtain priorities, or because of other wartime restrictions), he may obtain permission to establish a replacement fund in his accounts in which part or all of the compensation so received shall be held, without deduction for the amount so invested, pending the approval of a request for the establishment of a replacement fund.

The provisions of section 112 (f) are applicable to property used for residential or farming purposes.

The proceeds of a use and occupancy insurance contract, which by its terms is insured against actual loss sustained of net profits in the business, are not proceeds of an involuntary conversion but are income in the same manner that the profits for which they are substituted would have been.

There is no investment in property similar in character and devoted to a similar use if:

(6) The proceeds of an involuntary conversion are used in the business for which the property was converted.

It is incumbent upon a taxpayer "forthwith" to apply for and receive permission to establish a replacement fund in every case where it is not possible to replace immediately. If a.cpuendant proceeding was brought because of an expenditure in actual replacement would be too late, a request for the establishment of a replacement fund would likewise be too late.

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The proceeds of a use and occupancy insurance contract, which by its terms is insured against actual loss sustained of net profits in the business, are not proceeds of an involuntary conversion but are income in the same manner that the profits for which they are substituted would have been.

There is no investment in property similar in character and devoted to a similar use if:

(6) The proceeds of an involuntary conversion are used in the business for which the property was converted.

It is incumbent upon a taxpayer "forthwith" to apply for and receive permission to establish a replacement fund in every case where it is not possible to replace immediately. If acpuendant proceeding was brought because of an expenditure in actual replacement would be too late, a request for the establishment of a replacement fund would likewise be too late.
him all matters in dispute affecting the amount of the tax. Only surety companies holding certificates of authority from the Secretary of the Treasury are acceptable sureties on Federal bonds will be approved as sureties. The application should be executed in triplicate, so that the Commissioner, the applicant, and the surety or depositary may each have a copy.

§ 29.112 (g)–1 Purpose and scope of exception of reorganization exchanges—(a) Purpose. Under the general rule, upon the exchange of property, gain or loss must be accounted for if the new property differs in a material particular, either in kind or in extent, from the old property. The purpose of the reorganization Code is to except from the general rule certain specifically described exchanges incident to such readjustments of corporate structures, made in one of the particular ways specified in the Code, as are required by business exigencies, and which effect only a readjustment of continuing interests in property under modified corporate forms. Requisite to a reorganization under the Code are the holders of the stock and securities of either of the old corporations the requisite continuity of interest in the property, and which effect only a reorganization if the holders of the stock and securities of the old corporation are merely the holders of short-term notes in the new corporation. To include transactions not intended to be included, the specifications of the reorganization provisions of the law are precise. Both the terms of the specifications and their underlying assumptions and purposes must be satisfied in order to entitle the taxpayer to the benefit of the exception from the general rule. Accordingly, under the Code, a short-term purchase money note is not a security of a party to a reorganization, an ordinary dividend is to be treated as an ordinary dividend, and a sale is nevertheless to be treated as a sale, even though the mechanics of a reorganization have been set up.

§ 29.112 (g)–2 Definition of terms. The application of the term "reorganization" is to be strictly construed. The term is defined as set forth in section 112 (g) (1). The term does not embrace the mere purchase by one corporation of the properties of another corporation, for instance, the mere purchase of the entire stock of another corporation, the entire properties of which are transferred to the party to the reorganization exchanges for the purposes of the definition of a reorganization contained in section 112 (g) (1) (C), it may in some cases, however, so alter the character of the transaction as to place the transaction but merely provides that the requirement that the exchange be solely for voting stock is satisfied if the only additional consideration is an assumption of liabilities. A "recapitalization," and therefore a reorganization, takes place if, for example:

(c) A corporation, having its principal place of business in the District of Columbia, with a par value of its preferred stock in excess of $10,000,000, exchanges for a specified number of shares of its outstanding preferred stock, previously authorized but unissued, for outstanding common stock; or

(d) An exchange is made of a corporation's outstanding preferred stock, having certain priorities with reference to the holders of the stock and securities of the corporation to be reorganized.
to the amount and time of payment of dividends and the distribution of the corporate assets upon liquidation, for a new issue of such corporation's common stock, in pursuance of plan of reorganization.

The term "party to a reorganization" includes, in addition to a corporation which performs the specific act constituting the reorganization as described in section 112 (g) (2), (a) only a corporation specified in section 112 (g) (2). Both corporations are parties to the reorganization if under statutory authority Corporation A is merged into and Corporation B is consolidated into Corporation D, and both of the corporations are parties to the reorganization if, pursuant to statutory authority, Corporations C and D are consolidated into Corporation E. Both corporations are parties to the reorganization if it consists of the transfer by Corporations F and G of part of the assets of Corporation F in exchange for all of the capital stock of Corporation G. Only Corporation F is a party to the reorganization if it consists of the acquisition by Corporation H in exchange solely for all or a part of its voting stock of at least 80 percent of the total number of shares of all other classes of stock of Corporation J, even though such acquisition by Corporation H is from Corporation G.

The term "plan of reorganization" has reference to a consummated transaction specifically defined as a reorganization under section 112 (g) (1). The term is not to be broadened by the definition of "reorganization" as set forth in section 112 (g) (2), but is to be taken as limiting the nonrecognition of gain or loss to such exchanges as are directly a part of the transaction specifically described as a reorganization in section 112 (g) (1). Moreover, the transaction, or series of transactions, embraced in a plan of reorganization must not only be consummated, but must be consummated in accordance with section 112 (g) (1), but the readjustments involved in the exchanges effected in the consummation thereof must be undertaken for the purpose of the continuance of the business of a corporation a party to the reorganization. Section 112 (g) (2) contemplates genuine corporate reorganizations which are designed to effect a readjustment of continuing interests under modified corporate forms.

As used in section 112, as well as in other provisions of the Internal Revenue Code, if the context so requires, the conjunction "or" denotes both the conjunctive and the disjunctive, and the singular includes the plural. For example, the provisions of the statute are complied with if "each" asset is received as in exchange as well as if "stock or securities" are received.

§ 29.112 (g) -3 Exchanges solely of stock or securities, or property, solely for stock or securities, in pursuance of plan of reorganization. If a share of stock or securities of the same corporation, or of another corporation mentioned, or if one of such corporations transfers property to another of the corporations solely for stock or securities, in pursuance of plan of reorganization:
(a) The merger of Corporation A, in accordance with statutory authority, into Corporation B,
(b) The consolidation, pursuant to statutory authority, of Corporations C and D into Corporation E, a new corporation,
(c) The acquisition by Corporation F, in exchange solely for all or a part of its voting stock, of at least 80 percent of the total number of shares of all other classes of stock of Corporation J;
(d) The acquisition by Corporation H, in exchange solely for all or a part of its voting stock (disregarding any assumption of liabilities, as prescribed in section 29.112 -g (1)), of all the properties of Corporation I;
(e) The transfer by Corporation J of all or a part of its assets to Corporation K, if immediately after the transfer Corporation J or its stockholders, or both, are in control of Corporation K ("control" for the purpose of this transaction being defined in section 112 (h) as the ownership by Corporation J or its stockholders, other than Corporation K, to the extent of at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of other classes thereof); or
(f) The exchange of stock or securities solely for stock or securities of the same corporation in the case of (1) a recapitalization of a corporation, or (2) a merger in the identical, form, or place of organization of a corporation, however effected.

§ 29.112 (g) -4 Exchanges in reorganization for stock or securities and other property or money. If in an exchange for stock or securities of the same corporation or of another corporation a party to a reorganization, in pursuance of the plan of reorganization, for stock or securities in the same corporation or in another corporation a party to the reorganization, there is received by the taxpayer other property (not permitted to be received without the recognition of gain) or money, then
(a) As provided in section 112 (c) (1), the gain, if any, to the taxpayer will be recognized in an amount not in excess of the sum of the money and the fair market value of the other property, but
(b) The loss, if any, to the taxpayer from such an exchange is not to be recognized to any extent (see section 112 (e)).

Example. A, in connection with a reorganization, in 1942 exchanges a share of stock in the X Corporation purchased in 1929 at $160 for a share of stock of the Y Corporation (a party to the reorganization), which has a fair market value of $80, plus $70, the fair market value of the property received in the exchange. The tax on the gain of $70, if any, to the stockholder, is not to be recognized (see section 117). However, if the share of stock received had a fair market value of $70, the loss from the transaction of $10 would not be recognized.

If the distribution of such other property or money by or on behalf of a corporation in the course of a reorganization has the effect of the distribution of a liquidating dividend, then, as provided in section 112 (c) (2), there shall be taxed to each distributee (1) as a dividend, such amount of the gain recognized on the exchange as is not in excess of the distribution of the fair market value of the stock or securities constituting the reorganization as determined after February 28, 1913, and (2) as a gain from the exchange of property, the remainder of the gain recognized on the exchange.

Example. The X Corporation has a capital of $100,000 and earnings and profits of $50,000 accumulated since February 28, 1913. The X Corporation in 1942 transfers all of its assets to the Y Corporation in exchange for the issuance of all of the stock of the X Corporation and the payment of $50,000 in cash to the stockholders of the X Corporation. A, who owns one share of stock in the X Corporation, for which he in 1939 paid $100, receives 100 shares of stock in the Y Corporation worth $100 and the sum of $50 in cash in addition. A gain of $50 is recognized to A.

If, in pursuance of a plan of reorganization, property is exchanged for stock or securities in another corporation a party to the reorganization and other property or money, then, as provided in section 112 (c) (2), the gain or property or money received by the corporation is distributed by it pursuant to the plan of reorganization, no gain to the corporation will be recognized. If any other property or property distributed by the corporation is not distributed by it pursuant to the plan of reorganization, the gain, if any, to the corporation from the exchange will be recognized, under the provisions of section 112 (d) (2), in an amount not in excess of the sum of money and the fair market value of the other property so received which is not distributed. In effecting the exchange, the gain from the transaction will be recognized (see section 112 (e)).

For the proper treatment of an assumption of liabilities under section 112 (d) (2), and much of the remainder of the code relates to section 112 (b) (4), see section 112 (k) and the regulations prescribed thereunder. For the proper treatment of an assumption of liabilities under so much of section 112 (c) as relates to section 112 (b) (3), see § 29.112 (c) -1.

§ 29.112 (g) -5 Receipt of stock or securities in reorganization without surrender of stock by shareholder. Any distribution, though in pursuance of a plan of reorganization, to its shareholders without the surrender of their stock, by or on behalf of a corporation a party to a reorganization, of its stock or securities (other than its own stock, which is not eligible as a dividend) in exchange solely for stock or securities of another corporation a party to the reorganization, shall be taxed to such shareholders as a dividend, within the meaning of section 115, to the extent of the fair market value of such stock or securities at the date of the distribution is not in excess of (1) the earnings and profits of the corporation of the taxable year com-
§ 29.111-1.)

computed without regard to prior years and (2) the amount of the stock of the corporation accumulated after February 28, 1913, and prior to the taxable year. Any remainder of such fair market value of the stock or securities distributed over the earnings and profits of the corporation shall be applied against and used to reduce the basis provided in section 113 of the stock in respect to which the distribution was made; and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property.

(See § 29.111-1.)

§ 29.112 (g)-6 Records to be kept and information to be filed with returns.

(a) The plan of reorganization must be adopted by each of the corporations parties thereto; and the adoption must be shown by the acts of its duly constituted responsible officers, and shall appear upon the official records of the corporation. Each corporation a party to a reorganization shall file as a part of its return for its taxable year within which the reorganization occurred a complete statement of all facts pertinent to the nonrecognition of gain or loss in connection with the reorganization, including:

(1) A statement of the plan of reorganization, together with a statement under oath showing in full the purposes for which the reorganization occurred and the adoption of the plan, including a statement of all distributions and other disposition made thereof. The amount of each kind of stock or securities, transferred incident to, or pursuant to, the plan.

(2) A statement in full of the amount, nature and liability assumed under or in the exchange, including a statement of all distributions or other disposition made thereof. The amount of each kind of stock or securities transferred incident to the plan.

(3) A statement of the amount of stock or securities and other property or money received from the exchange, including a statement of all distributions or other disposition made thereof. The amount of each kind of stock or securities transferred incident to the plan.

(d) A statement of the amount and nature of any liabilities assumed upon the plan...

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of this section, section 112 (k) provides, however, that:

(1) Liabilities assumed are not to be treated as “other property or money” under section 112 (c) or (d), if the transactions would, but for the receipt of “other property or money,” have been exchanges of the type described in section 112 (b) (4) or (5); and

(2) If the only type of consideration received by the transferee in addition to that permitted to be received by section 112 (b) (4) or (5), consists of an assumption of liabilities, the transaction, if otherwise qualified, shall be deemed to be within the provisions of section 112 (b) (4) or (5).

The application of this paragraph may be illustrated by the following example:

Example: A, an individual, transfers to a controlled corporation property with an adjusted basis of $10,000 in exchange for stock of the corporation with a fair market value of $8,000, cash in the amount of $3,000, and the assumption of indebtedness of A amounting to $4,000. A’s gain is $5,000, computed as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock received</td>
<td>$8,000</td>
</tr>
<tr>
<td>Cash received</td>
<td>3,000</td>
</tr>
<tr>
<td>Liabilities assumed</td>
<td>4,000</td>
</tr>
<tr>
<td>Total consideration</td>
<td>15,000</td>
</tr>
<tr>
<td>Less: Adjusted basis</td>
<td>10,000</td>
</tr>
<tr>
<td>Gain realized</td>
<td>5,000</td>
</tr>
</tbody>
</table>

Assuming that the transaction falls within section 115 (c) as a transaction which would have been within section 112 (b) (5) but for the receipt of “other property or money,” only so much of such $5,000 gain will be recognized as does not exceed the “other property or money” received. Since section 112 (c) provides that an assumption of liabilities shall not constitute “other property or money,” the only “other property or money,” received, is the $3,000 cash, and the $5,000 realized gain will be recognized only to that extent.

(b) Exceptions and limitations. The benefits of section 112 (c) do not extend to any exchange involving an assumption of liabilities where it appears that the principal purpose of the taxpayer with respect to such assumption was a purpose to avoid Federal income tax on the exchange, or, if not such purpose, was not a bona fide business purpose. In such cases, the amount of the liabilities assumed shall, for the purposes of determining the amount of gain to be recognized upon the exchange, be treated as the liabilities actually assumed by the taxpayer upon the exchange. The liabilities assumed are to be treated as the liabilities actually assumed by the taxpayer, or, proceeding where the burden is on the taxpayer to prove that an assumption of liabilities is not to be treated as “other property or money” under section 112 (k), which is the case if the Commissioner determines that the taxpayer’s purpose with respect thereto was a purpose to avoid Federal income tax on the exchange or was not a bona fide business purpose and the taxpayer contests such determinations by litigation, the taxpayer must sustain such burden by the clear preponderance of the evidence. Thus, the taxpayer must prove by the clear preponderance of all the evidence that the absence of a purpose to avoid Federal income tax on the exchange, or the presence of a bona fide business purpose, is unimpeachable.

Sec. 113. Adjusted Basis for Determining Gain or Loss—(a) In case of a transfer (as defined in section 112) the basis of the property shall be the cost of such property; except that—

§ 29.113 (a)–1 Scope of basis for determining gain or loss. The basis of property for the purpose of determining gain or loss from the sale or other disposition thereof is the unadjusted basis prescribed in section 113 (a), adjusted for the various applicable items specified in section 113 (b). When no unadjusted basis is indicated, the word “basis,” as used in this section and in §§ 29.113 (a)–2 to 29.113 (a) (21)–1, inclusive, has reference to the unadjusted basis. For special rules for determining the basis for gain or loss in the case of vessels acquired through the Maritime Commission, see sections 610 and 511 of the Merchant Marine Act of 1936, as amended. For special rules for determining the unadjusted basis of property recovered in respect of war losses, see section 127 (d).

§ 29.113 (a)–2 General rule. In general, the basis of property is the cost thereof. This rule is subject, however, to the exceptions stated in sections 113 (a) (1) to 113 (a) (21), inclusive.

(b) Basis (adjusted) of property. The basis of property shall be the cost of such property, except that—

(1) Gifts. If the property should have been included in the last inventory, the basis shall be the last inventory value thereof.

§ 29.113 (a) (1)–1 Property included in inventory. The last inventory value of property which should be included in inventory is the basis of such property. The requirements with respect to the valuation of the assets are stated in §§ 29.23 (c)–1 to 29.23 (d)–1, inclusive.

Sec. 113. Adjusted Basis for Determining Gain or Loss—(a) As amended by secs. 213, 214, 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 216 (a), 216 (b), 223 (b), Rev. Act 1944; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 139 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (b), Rev. Act 1942.

§ 29.113 (b) (1) Basis (adjusted) of property. The basis of property shall be the cost of such property; except that—

(2) Gifts after December 31, 1941. If the property was acquired by gift after December 31, 1941, the uniform basis to which such uniform basis is applicable, whether such person is any other person than the donee under the instrument of gift, or the last preceding owner, shall be such fair market value at the time of the gift, as is unmistakable.

(3) Gifts after December 31, 1940. If the property was acquired by gift before December 31, 1940, the uniform basis to which such uniform basis is applicable shall be such fair market value at the time of the gift, as is unmistakable.
The time of the gift is the time when the gift is consummated. Delivery, actual or constructive, is the time when the property, in determining the time of the gift, the passing of title by the donor is not decisive; the time when the donor relinquishes substantial dominion over the property is decisive.

(c) Fair market value. For the purposes of this section, the value of property as appraised for the purpose of the Federal gift tax, or if the gift is not subject to such tax, its value as appraised for the purpose of the Federal gift tax, is the fair market value of the property at the time of the gift.

(d) Reinvestment by fiduciary. If the property is an investment by the fiduciary under the terms of the gift (as, for example, in the case of a sale by the fiduciary of property transferred under the terms of the gift, and the reinvestment of the proceeds), the cost or other basis to the fiduciary is taken in lieu of the basis specified in paragraph (b) of this section.

(e) Records. To insure a fair and adequate determination of the proper basis under section 113 (a) (2), persons making or receiving gifts of property should preserve and keep accurate records or accounts to determine the cost of the property and, if pertinent, its fair market value as of March 1, 1913.

§ 29.113 (a) (3) Transfer in trust after December 31, 1930. If the property was acquired after December 31, 1930, by transfer in trust, it does not apply to property acquired by bequest, devise, or devisee, or by an instrument which, under section 113 (a) (5), is treated as though it were a will, and applies to such property only at the times and to the extent prescribed in section 113 (a) (5).

§ 29.113 (a) (4) Transfer in trust after December 31, 1930. If the property was acquired after December 31, 1930, by transfer in trust, it does not apply to property acquired by bequest, devise, or devisee, or by an instrument which, under section 113 (a) (5), is treated as though it were a will.

(b) Basis. The basis of the fair market value of such property at the time of the gift or at the time of the transfer in trust. Such fair market value is to be ascertained in the manner prescribed in paragraph (c) of § 29.113 (a) (2) or, by equivalent methods.

§ 29.113 (a) (5) Property transferred in trust. If the property was transferred in trust, the basis shall be the fair market value of such property at the time of such transfer.

§ 29.113 (a) (6) Property transferred at death. If the property was acquired by bequest, devise, or devisee, or by an instrument which, under section 113 (a) (5), is treated as though it were a will, and applies to such property only at the times and to the extent prescribed in section 113 (a) (5).

(b) Basis. The basis of the fair market value of such property at the time of the grantor's death. For the purpose of this section, the basis of property acquired by bequest, devise, or devisee, or by an instrument which, under section 113 (a) (5), is treated as though it were a will, and applies to such property only at the times and to the extent prescribed in section 113 (a) (5).

(b) Basis. The basis of property included. Section 113 (a) (6) applies: (1) To all property passing from a decedent by will or under the law governing the descent and distribution of property of decedents; and (2) To property passing under an instrument which, under section 113 (a) (5), is treated as though it were a will, and applies to such property only at the times and to the extent prescribed in section 113 (a) (5).

(b) Basis. Section 113 (a) (6) provides three rules for determining the basis of property transferred after the grantor's death.

(1) First, a rule providing governing generally, second, a special rule governing stock in a foreign personal holding company, and, third, a special rule applicable only in the cases where for estate tax purposes the decedent's gross estate is valued at the optional valuation date.

(2) General rule. Except as prescribed in subparagraphs (2) and (3) of this paragraph, the basis of property subject to section 113 (a) (5), is treated as though it were a will, and applicable to such property only at the times and to the extent prescribed in section 113 (a) (5).

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his lifetime the income of the property bequeathed, and after his death to distribute such property to the survivors of a class, and upon A’s death the property is distributed to the taxpayer as the sole survivor, the basis of such property, in the hands of the taxpayer, is its fair market value at the time when the decedent died.

The purpose of the Internal Revenue Code, in prescribing a general uniform basis-rule for property acquired by bequest, devise, or inheritance, is on the one hand, to tax the gain, in respect of such property, to him who realizes it (without regard to the circumstance that at the death of the decedent it may have been given in respect to the taxable year the taxpayer would take or gain anything); and, on the other hand, not to recognize as gain any element of value solely from the circumstance that the possession or enjoyment by the taxpayer was post-poned. Such postponement may be, for example, until the administration of the decedent’s estate is completed, until the period of reasonable probate another has terminated, or until an uncertain event has happened. It is the increase or decrease in the value of property reflected in a sale or other disposition of property acquired by bequest, devise, or inheritance, the basis of the property is always the same.

Whether such person be the executor, administrator, or the trustee. Whether such person be the executor, administrator, or the trustee, of the estate of the decedent or any estate or trust created by the will, or any beneficiary of such trust, and whatever the nature of any such person's interest or estate may be.

Adjustments to basis. In the hands of every person who acquires the property of a decedent (or any estate or interest therein) by bequest, devise, or inheritance, the basis of the property is always the same.

Whether during or after administration and settlement of the estate of the decedent, during or after the term of any trust under the will, or before or after the distribution of the estate by the executor or administrator, or the trustee.

Adjustments to basis required by section 113 (b) are made in accordance with the same principles. Thus, the deductions for depreciation and the depletion allowed or allowable, under section 23 (I) and section 23 (m), to a legal life tenant as if the life tenant were the absolute owner of the property, constitute an adjustment to the basis of the property in the hands not only of the life tenant, but also in the hands of the remainderman and every other person to whom the same uniform basis is applicable. Similarly, the deductions allowed or allowable under section 23 (I) and section 23 (m), both to the trustee and to the trust beneficiaries, constitute an adjustment to the basis of the property in the hands not only of the trustee, but also in the hands of the trust beneficiaries and every other person to whom the uniform basis is applicable. See, however, section 24 (a).

Similarly, adjustments in respect of capital expenditures or losses, tax-free distributions, or other distributions applicable in reduction of basis, or other items for which the basis is adjustable, with regard to which one of the persons to whom the same uniform basis is applicable makes the capital expenditures or sustains the capital losses, or to whom the tax-free distributions or other items for which adjustment to basis is required to be made, or to whom the deductions are allowed or allowable.

The executor or other legal representative of the decedent, the fiduciary of a trust under a will, the life tenant and every other person to whom a uniform basis under this section is applicable, shall make and maintain records showing in detail all deductions, distributions, or other items for which adjustment to basis is required to be made, and shall furnish to the Commissioner information with respect to such matters in such detail at such time and in such manner as the Commissioner may require.

Sales of remainder and other interests in property transmitted at death. The following is an illustration of the rule stated in paragraphs (1) and (2) of this section that, under section 113 (a) (5), the measure of gain or loss resulting from a sale or other disposition of property transmitted at death is the increase or decrease in the value of the property reflected in such sale or other disposition: If land is left for life to A, with remainder in fee to B, and prior to A’s death, B sells his remainder, the incurrence or decrease in the value of the property reflected, and realized by B, in the proceeds from the sale of his remainder interest constitutes the gain recognized upon the sale. (See section 111.) Such gain (or as the case may be, the loss) is computed by comparing the amount of the proceeds received from the sale with the amount of the part of the uniform basis assignable to such sale of B’s remainder interest. The part of the uniform basis assignable to such a sale by B is the part of the uniform basis (adjusted to the time of the sale) of the land transmitted from the decedent which bears the same proportion to the uniform basis as B’s remainder interest, at the time of the sale, bears to the whole estate in the land transmitted from the decedent.

Basis (unadjusted) of property. The basis of property shall be the cost of such property; except that—

Tax-free exchanges generally. If the property was acquired, after February 28, 1913, upon an exchange described in section 112 (b) to (e), inclusive, the basis (except as provided in paragraphs (15), (17), or (19) of this section) shall, in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of any money paid by the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of
the type of property permitted by section 112 (b) to be received without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. Where as part of the consideration another property is transferred to the taxpayer assumed a liability of the taxpayer or acquired from the taxpayer property subject to a liability, such assumption or acquisition (in the amount of the liability) shall, for the purposes of this paragraph, be considered as money received by the taxpayer. This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it.

§29.113 (a) (6)–1 Property acquired upon a tax-free exchange. In the case of an exchange, after February 28, 1913, of properties of the type described in section 112 (b), if no part of the gain or loss was recognized under the law applicable to the year in which the exchange was made, the basis of the property acquired as the basis of the property transferred by the taxpayer with proper adjustments to the date of the exchange.

If, in an exchange, after February 28, 1913, of properties of the type indicated in section 112 (b), gain to the taxpayer was recognized under the provisions of section 112 (c) or (d) or a similar provision of a prior Revenue Act, on account of the receipt of money in addition to the property transferred, the basis of the property acquired is the basis of the property transferred (adjusted to the date of the exchange), decreased by the amount of money received and increased by the amount of gain recognized on the exchange. For example: A purchased a share of stock in the X Corporation in 1927 for $100. Pursuant to a plan of reorganization, B exchanged a share for one share in the Y Corporation, worth $90, and $30 in cash. A realized a gain of $20 upon the exchange and the property was transferred to B with a basis of $120. C, in an exchange for all the capital stock in the Y Corporation, receives $75,000 for the capital stock of the X Corporation and the assumption of the mortgage. Basis of the mortgage, but which is made subject to the exchange and has a fair market value of $50,000, is $150,000.

Section 112 (e) and similar provisions of prior Revenue Acts provide that no loss may be recognized on an exchange of properties of a type described in section 112 (b) unless such other property is received other property or money from the transaction. However, the basis of the property or properties received by the taxpayer (other than money) is the basis (adjusted to the date of the exchange) of the property transferred, decreased by the amount of money received. The basis shall be apportioned to the properties received, and for this purpose there must be allocated to such other property (not permitted to be exchanged tax free) an amount of such basis equivalent to the fair market value of such other property at the date of the exchange.

Section 113 (a) (6)–2 Treatment of assumptions of liabilities. For the purposes of section 113 (a) (6) the amount of any liabilities of the taxpayer assumed by the other party to the exchange is to be treated as money received by the taxpayer upon the exchange, whether or not the assumption of liabilities resulted in a recognition of gain or loss to the other party to the transaction and if so, to the year in which the exchange was made.

The application of this section may be illustrated by the following examples:

Example (1). A, an individual, owns property having an adjusted basis of $20,000 and on which there is a purchase money mortgage of $25,000. On September 1, 1942, A organizes the X Corporation and transfers the property to the X Corporation; and at the same time he transfers the property above described in exchange for all the capital stock of the X Corporation and the assumption of the mortgage. The capital stock of the X Corporation has a fair market value of $150,000.

The amount of gain recognized is $20,000 and the gain is realized.

Example (2). B, an individual, owns an apartment house which has an adjusted basis in his hands of $500,000, but which is subject to a mortgage of $500,000. On September 1, 1942, B exchanges such apartment house to C, receiving in exchange therefor $500,000 in cash and in addition another apartment house with a basis of $500,000. The basis of the apartment house acquired by B upon the exchange is $500,000, computed as follows:

<table>
<thead>
<tr>
<th>Property Acquired</th>
<th>Amount of Money Received</th>
<th>Amount of Liabilities Assumed by X Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$500,000</td>
<td>$500,000</td>
</tr>
</tbody>
</table>

The basis of the apartment house acquired by B shall be its fair market value at the date of the exchange.
§ 29.113 (a) (7)–1 Property acquired by corporation in reorganization after December 31, 1917. (7) sets forth the conditions under which the basis of property acquired by a corporation after December 31, 1917, in connection with a reorganization as defined in section 113 (a) (7), is the same as it would be in the hands of the transferor if the property had been transferred by him directly to the transferee at the time of the transfer, decreased as therein provided in the amount of gain or loss recognized to the transferor under the applicable revenue law. In the case of property so acquired in a taxable year beginning prior to January 1, 1936, such basis is applicable only if immediately after the transfer there remained in the same persons or any of them an interest or control in such property remaining, immediately after the transfer, in the hands of the same persons or any of them.

The application of the provisions of section 113 (a) (7) may be illustrated by the following examples:

Example (1). In 1925 the X Corporation caused the organization of the Y Corporation and transferred to the Y Corporation, in exchange for the stock or securities of the X Corporation, property which it had previously purchased for $10,000. The basis of the property in the hands of the Y Corporation is $10,000.

Example (2). In 1925 the M Corporation exchanged 10 percent of its voting stock for all of the property of the N Corporation. The M Corporation had a basis of $10,000 in the hands of the N Corporation. The basis of the property in the hands of the M Corporation is cost thereof to it at the time of the transfer, that is, the fair market value of the M stock exchanged for the property.

Section 113 (a) (7) does not apply if, irrespective of when acquired, the property comprised or any portion of which comprised a corporation a party to a reorganization as defined in section 113, unless such stock or securities are acquired by the issuance of stock or securities of the transferring corporation, or for stock or securities of the transferee corporation, or in part for the transfer. The application of the last sentence of section 113 (a) (7) to a case where such stock or securities are acquired by the issuance of stock or securities of the transferee may be illustrated as follows:

Example (3). The Y Corporation owns all of the stock of the X Corporation, which stock it purchased in 1925 by the issuance of all of its own voting stock. X Corporation was organized by the Y Corporation, and a basis of $10,000,000 in the hands of the Y Corporation had a fair market value of $1,000,000 at the time it was exchanged in 1949 for the stock of the X Corporation. The fair market value of the stock of the X Corporation at the time of the exchange was $3,000,000. The basis to the Y Corporation of the stock of the X Corporation is the basis which such stock would have had in the hands of the individuals from whom acquired by the Y Corporation, that is, $200,000.

§ 29.113 (a) (9)–1 Property acquired as a result of an involuntary conversion. The provisions of section 113 (a) (9) may be illustrated by the following example:

Example. A vessel purchased by A in 1927 for $1,000,000 is destroyed in 1942 and A receives insurance in the amount of $1,000,000 with regard to the vessel. For the purpose of this example, the adjustment for depreciation, if A invests $1,000,000 in a new vessel, taxable gain to the extent of $600,000 would be the basis of the new vessel; that is, the cost of the old vessel ($1,000,000) minus the proceeds received ($400,000) which was not expended in the acquisition of the new vessel ($800,000) plus the amount of gain recognized on such conversion ($200,000). If any amount in excess of the proceeds of the conversion is expended in the acquisition of the new property, such amount may be added to the basis otherwise determined.

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN ON LOSS—AS AMENDED BY SEC. 234 (d), 110 (b), 221 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (a), 126 (c), 130 (b), 142 (c), 143 (a) (b), 144 (a), 171 (b), Rev. Act 1942.]

(a) Basis (unadjusted) of property. The basis of property shall be the cost of such property except that—

(10) Wash sales of stock. If the property consists of stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the nondeductibility (under section 113 (a) (7), because of the transfer of such property to the corporation was property or money, in addition to such stock or securities), or (B) as paid-in surplus or as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of loss recognized to the transferee upon such transfer under the law applicable to the year in which the transfer was made.

Example (4). A purchased a share of common stock of the X Corporation for $100 in 1927, which he sold January 16, 1942, for $80. On February 1, 1942, he purchased a share of common stock of the same corporation for $90. No loss from the sale is recognized under section 113. The basis of the old stock is $110. If, as a result of this exchange of $10, the excess of the price at which the new stock was acquired over the price at which the old stock was sold ($90) over the price at which the old stock was sold ($90) over the price at which the new stock was acquired ($90).

Example (5). A purchased a share of common stock of the X Corporation for $100 in 1927, which he sold January 15, 1942, for $80. On February 1, 1942, he purchased a share of common stock of the same corporation for $90. No loss from the sale is recognized under section 113. The basis of the new stock is $90; that is, the basis of the old stock ($100) decreased by $10, the excess of the price at which the old stock was sold ($90) over the price at which the new stock was acquired ($90).

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN ON LOSS—AS AMENDED BY SEC. 234 (d), 110 (b), 221 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (a), 126 (c), 130 (b), 142 (c), 143 (a) (b), 144 (a), 171 (b), Rev. Act 1942.]

(a) Basis (unadjusted) of property. The basis of property shall be the cost of such property except that—

(10) Wash sales of stock. If the property consists of stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the nondeductibility (under section 113 (a) (7), because of the transfer of such property to the corporation was property or money, in addition to such stock or securities), or (B) as paid-in surplus or as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of loss recognized to the transferee upon such transfer under the law applicable to the year in which the transfer was made.
The basis of property after a consolidated return period shall be the same as immediately prior to the close of such period. For example, if a corporation having a member of an affiliated group which has made annual returns in the calendar year for the taxable year 1941 and makes a separate return for the taxable year 1942 and succeeding taxable years, the value of the opening inventory used to be computed in such corporation's net income for the taxable year 1942 is the proper value of the closing inventory used in computing the consolidated net income for the preceding taxable year.

§ 29.113 (a) (11)–1 Basis of property acquired during affiliation. The basis of property acquired by a corporation during a period of affiliation with a corporation with which it was affiliated shall be the same as the basis in the hands of the corporation from which acquired. This rule is applicable if the basis of the property is material in determining tax liability for any year, whether a separate return or a consolidated return is made in respect of such taxable year, in respect of which a consolidated return is made by such corporation under section 113 of this chapter, or the Revenue Act of 1932 or the Revenue Act of 1934 or the Revenue Act of 1936 or the Revenue Act of 1938. The basis in the case of property held by a corporation during any period, in the tax year in which or any subsequent taxable year, in respect of which a consolidated return is made by such corporation under section 113 of this chapter, or the Revenue Act of 1932 or the Revenue Act of 1934 or the Revenue Act of 1936 or the Revenue Act of 1938, is determined in accordance with regulations prescribed by the Board of Tax Appeals or the Secretary of the Treasury, as the case may be, in the application of the provisions of this section, the term "period of affiliation" means the period during which such corporations were affiliated (determined in accordance with the law applicable thereto), but does not include any taxable year beginning on or after January 1, 1932, unless a consolidated return was made, nor after the taxable year 1928.

The basis of property acquired by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return is made or is required under Regulations 75, Regulations 78, Regulations 85, Part 4, Part 16 or Part 14 of this chapter or the subsequent regulations relating to consolidated returns, shall be adjusted in respect of any items relating to such period in accordance with such regulations.

For the purposes of this paragraph, the term "period of affiliation" means the period during which such corporations were affiliated (determined in accordance with the law applicable thereto), but does not include any taxable year beginning on or after January 1, 1929, unless a consolidated return was made, nor after the taxable year 1928.

Accordingly, the term "period of affiliation" means the period during which such corporations were affiliated (determined in accordance with the law applicable thereto), but does not include any taxable year beginning on or after January 1, 1929, unless a consolidated return was made, nor after the taxable year 1928. The basis in the case of property acquired by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return is made or is required under Regulations 75, Regulations 78, Regulations 85, Part 4, Part 16 or Part 14 of this chapter or the subsequent regulations relating to consolidated returns, shall be adjusted in respect of any items relating to such period in accordance with such regulations.

The basis of property after a consolidated return period shall be the same as immediately prior to the close of such period. For example, if a corporation having a member of an affiliated group which has made annual returns in the calendar year for the taxable year 1941 and makes a separate return for the taxable year 1942 and succeeding taxable years, the value of the opening inventory used to be computed in such corporation's net income for the taxable year 1942 is the proper value of the closing inventory used in computing the consolidated net income for the preceding taxable year.

For the purposes of this section, the term "period of affiliation" means the period during which such corporations were affiliated (determined in accordance with the law applicable thereto), but does not include any taxable year beginning on or after January 1, 1929, unless a consolidated return was made, nor after the taxable year 1928. The basis in the case of property acquired by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return is made or is required under Regulations 75, Regulations 78, Regulations 85, Part 4, Part 16 or Part 14 of this chapter or the subsequent regulations relating to consolidated returns, shall be adjusted in respect of any items relating to such period in accordance with such regulations.

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property, except that—

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basis.

[33x546]cost or other basis thereof to the con-

tributed in kind

[33x608]hands of his partnership interest as is prop-

[33x616]is proper allocable to such property.

[33x623]basis of such property in the hands of the

[33x630]partnership interest as is prop-

[33x638] applicable to the year in which the transfer

[33x645]It would be in the hands of the transferor,

[33x660]termining the distributive shares of the

[33x690]distribute in kind and not in cash, the partner re-

[33x698]tributed or disposed of the property as pro-

vided in § 29.111—. See also section 117.

If the partnership distributes its assets

record in kind and not in cash, the partner real-

izes no gain or loss on the disposition or de-

losses of the property received in liquidation.

The basis of such property in the hands of the

partnership shall be such part of the basis

of such property in the hands of the partner

the basis of partnership inter-

is properly allocable to such property.

a partner shall be such part of the basis

of the property in the hands of the partner

The basis of property in the hands of the

partnership and the basis is not otherwise de-

termined under any other paragraph of this

paragraph of this section, the amount of loss

[44x202]§ 29.111-1. See also section 117.

If the partnership distributes its assets

basis record in kind and not in cash, the partner

realizes no gain or loss on the disposition or

losses of the property received in liquidation.

The basis of such property in the hands of the

partnership shall be such part of the basis

of such property in the hands of the partner

the basis of partnership interest as is prop-

[59x735]Basis (unadjusted) of property.

Partnerships.

If a new partner is admitted to the

partnership, or an existing partnership is

reorganized, so that such change or reorganiza-

tion should be fully set forth in the next return

of income, in order that the Commissioner may
determine whether any gain has been realized

or loss sustained by any partner.

The basis of property shall be the cost of

such property; except that—

a) Property acquired before March 1, 1913, for

the basis otherwise provided in this section,

the amount of loss recognized to the

partner realising or disposing of the property,

the property was distributed

three months after March 1, 1913,

the basis of property whether acquired

in kind or not in cash, the partner real-

izes no gain or loss on the disposition or

losses of the property received in liquidation.

The basis of such property in the hands of the

partnership shall be such part of the basis

of such property in the hands of the partner

the basis of partnership interest as is proper-

[289x382]distributes its assets

in liquidation.

In determining the fair market value of

the corporate assets on such date. In the

case of property traded in on public ex-

changes, the value is considered as fixed

on the date of the exchange. In the case

of property traded in on other than public

exchanges, the value is considered as fixed

on a date prescribed in the Revenue Act of

1935, if:

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(a) Such property was received in a liquidation which was completed before June 23, 1936.
(b) Such liquidation constituted a complete liquidation within the meaning of section 112 (b) (6) of the Revenue Act of 1934, as amended by the Revenue Act of 1938;
(c) No gain or loss would have been recognized under section 112 (b) (6) of the Revenue Act of 1934, as amended; or
(d) The recipient corporation was a liquidating corporation within 180 days after the enactment of the Revenue Act of 1938 under regulations prescribed under section 806 of the Revenue Act of 1938, (Treasury Decision 4815) to have such basis apply to such property.

If such an election was made, the basis of such property received in liquidation shall be the cost or other basis (adjusted as provided in section 113) of the stock of the liquidating corporation surrendered in exchange for the property, decreased in the amount of money received and increased in the amount of gain or decreased in the amount of loss to the recipient corporation that was recognized under section 112 (b) (6) of the Revenue Act of 1938. If such property consists of more than one class of property the basis shall be allocated among the several properties (other than money) acquired in a transaction bears to the fair market value of all such properties on that date.

§ 113. Adjusted basis for determining gain or loss—sec. 3. 213 (a), 214 (a), 215 (b), 223 (b), Rev. Act 1938; sec. 1, Pub. Law 18, approved March 17, 1941; sec. 115 (b), 120 (c), 130 (b), 145 (b) (c), 148 (b), 144 (b), 171 (b), Rev. Act 1938. (b) Basis (unadjusted) of property. The basis of property shall be the cost of such property acquired.

§ 113. Adjusted basis for determining gain or loss—sec. 3. 213 (a), 214 (a), 215 (b), 223 (b), Rev. Act 1938; sec. 1, Pub. Law 18, approved March 17, 1941; sec. 115 (b), 120 (c), 130 (b), 145 (b) (c), 148 (b), 144 (b), 171 (b), Rev. Act 1938. (b) Basis (unadjusted) of property. The basis of property shall be the cost of such property, except that—

(16) Basis established by revenue act of 1934. If the property was acquired, after February 20, 1913, in any taxable year beginning prior to January 1, 1937, and the basis thereof for the purposes of the Revenue Act of 1934 was prescribed by section 113 (a) (b), (7), or (8) of that Act, then for the purposes of the Internal Revenue Code the basis shall be the same as the basis therein prescribed in the Revenue Act of 1934.

§ 113.113 (a) (16) Basis of property established by Revenue Act of 1934. Section 113 (a) (16) provides that if property was acquired after February 28, 1913, in any taxable year beginning prior to January 1, 1936, and the basis of the property prescribed by the Revenue Act of 1934 was prescribed by section 113 (a) (6), (7), or (8) of that Act, then for the purposes of the Internal Revenue Code the basis shall be the same as the basis therein prescribed in the Revenue Act of 1934. For example, if after December 31, 1930, and in any taxable year beginning prior to January 1, 1936, property was acquired by a corporation by the issuance of its stock or securities in connection with a transaction which is not described in section 112 (b) (5) of the Code but which is described in sec. 26 CFR 3.113 (a) (15) (1).
(B) Where the new stock consisted of rights to acquire stock which was sold in a taxable year beginning before January 1, 1939, and there was included in the gross income for such year the entire amount of such proceeds, the basis of the new stock or the old stock was sold or disposed of in a taxable year beginning prior to January 1, 1939, the taxpayer has not asserted by a claim for a refund or by an amendment to the return for such year the basis of the proceeds of such sale, and no part of the proceeds of such sale, then, if before the date of the enactment of the Revenue Act of 1939 the taxpayer has not asserted by a claim for a refund or by an amendment to the return for such year the basis of the old stock shall be determined without regard to subparagraph (A); and no part of the proceeds of the sale of such new stock should be excluded from gross income for such year, the basis of such stock, and after such inclusion such amount was included, as a dividend, in gross income for such year an amount on account of such stock in respect of which the distribution was made, or the stock acquired in the exercise of such rights shall (except as otherwise prescribed in § 29.113 (a) (19)–2) be ascertained in accordance with the principles set forth in § 29.113 (a) (19)–2.

(c) Stock rights acquired before January 1, 1925. In the case of stock in respect of which were acquired prior to January 1, 1925, stock subscription rights which were distributed as a dividend to the shareholder within the meaning of the sixteenth amendment to the Constitution, and in the case of such rights, the basis for determining gain or loss with respect to the stock in respect of which the distribution was made, or the subscription rights distributed, or the stock acquired in the exercise of such rights shall (except as otherwise prescribed in § 29.113 (a) (19)–1) not apply with respect to the old stock, the new stock, or the subscription rights to acquire new stock, remaining on hand after a sale or other disposition of the old stock, subscription rights, or new stock in a taxable year beginning prior to January 1, 1939, if the basis for determining gain or loss on such sale or other disposition was fixed by a closing agreement or by a closing agreement which was entered into before September 26, 1939, and if the basis for determining gain or loss upon such sale or other disposition was fixed by a method other than that of allocation of basis provided by the general rule. In such cases, the basis for determining gain or loss with respect to the remaining shares shall be fixed in a manner consistent with the prior determination to the end that the sale or other disposition is a tax-free recovery of the total cost or other basis of his original shares, and no more.

§ 29.113 (a) (19)–2 Exceptions to general rules—(a) Proceeds of sales reported as income. In the case of stock rights sold in a taxable year beginning prior to January 1, 1939, the general rules for ascertaining the basis for determining gain or loss with respect to the stock in respect of which the distribution was made, or the subscription rights distributed, or the stock acquired in the exercise of such rights shall (except as otherwise prescribed in § 29.113 (a) (19)–2) be ascertained in accordance with the principles set forth in article 39 of Regulations 65.

§ 29.113 (a) (19)–1 Basis of stock and rights involved in the acquisition of stock dividends or stock rights; general rules—(a) Stock dividends. In the case of stock in respect of which was acquired a stock dividend, the basis of such stock dividends or the stock rights had not been acquired, and the basis with respect to the old stock shall be the same as though the rights were acquired in the exercise of such rights, and the basis with respect to the old stock shall be determined without regard to subparagraph (A); and no part of the proceeds of such sale shall be excluded from gross income for such year. In such cases, the basis for determining gain or loss with respect to the old stock shall be determined without regard to paragraph (a) and no part of the proceeds of such sale shall be excluded from gross income for such year.

§ 29.113 (a) (19)–2 In the case of stock in respect of which were acquired stock dividends or the stock rights had not been acquired, and the basis with respect to the old stock shall be determined without regard to paragraph (a) and no part of the proceeds of such sale shall be excluded from gross income for such year.

§ 29.113 (a) (19)–3 In the case of stock in respect of which were acquired stock dividends or the stock rights had not been acquired, and the basis with respect to the old stock shall be determined without regard to paragraph (a) and no part of the proceeds of such sale shall be excluded from gross income for such year.
court having jurisdiction of the proceeding...

If the conditions of section 113 (a) (20) are satisfied the purpose of determining basis, the provisions of section 113 (a) (20) only shall apply, notwithstanding that the transaction might also fall within another provision of section 113.

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS AS AMENDED BY SEC. 213 (d)].

214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; sec. 113 (a) (20), 125 (b) (c), 144 (a) (b), 144 (a), 171 (b), Rev. Act 1942.

(a) Adjusted basis. The adjusted basis for determining the gain or other disposition of property, whenever acquired, shall be the basis determined under subsection (a) (21), adjusted to hereinafter provided

1. (General rule. Proper adjustment in respect of the property shall in all cases be made

(a) For expenditures, receipts, losses, or other items, properly chargeable to capital account, the amount shall be made for taxes or other charges carrying for which deductions have been taken by the taxpayer in determining net income for the taxable year or prior taxable years;

(b) In respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent sustained;

(c) In the case of stock (to the extent not allowed for in the recouping subparagraphs) for the amount of distribution received which, under the law applicable to the corporation in the year in which the distribution was made, otherwise would be deductible in reduction of basis (not including distributions made by a corporation, which was classified as a personal holding company under the provisions of the Revenue Act of 1918, Feb. 23, 1919, c. 18, 40 Stat. 1037, or the Revenue Act of 1921, Nov. 22, 1921, c. 231, 42 Stat. 227, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or 1921);

(d) To the extent provided in section 225 (1) in the case of the stock of United States shareholders in a personal foreign holding company; and

(e) To the extent provided in section 225 (b) in the case of amounts specified in a shareholder's consent under section 225.

2. In the case of property pledged to the Commodity Credit Corporation, to the extent of the amount required to be paid to the Commodity Credit Corporation and treated by the taxpayer as income for the year in which received pursuant to section 123 of this chapter, and to the extent of any deficiency, on such loan with respect to which the taxpayer has been relieved from liability.

3. In the case of any bond (as defined in section 125) the interest on which is wholly exempt from the tax imposed by this chapter, to the extent such interest was treated as maximum deductible as a deduction pursuant to section 225 (a) (3), and in the case of any other bond (as defined in such section) to the extent of the deductions allowable pursuant to section 225 (a) (1) with respect thereto.

§ 29.113 (b) (1) Adjusted basis; general rule. The adjusted basis for determining the gain or loss from the sale or other disposition of property is the cost of such property as is described in section 113 (a) (1) (21), inclusive, the basis therein provided, adjusted to the extent provided in section 113 (b).

The cost or other basis shall be properly adjusted for any expenditure, receipt, loss, or other item, properly chargeable to capital account, including the cost of improvements and betterments made to the property. In the case of mines and oil or gas wells the following shall not be considered as items properly chargeable to capital account:

(1) Expenditures made by the taxpayer in the year 1912 or subsequent taxable years which are allowable under article 235 or 236 of Regulations 77, article 23 (m)-15 or (m)-16, article 24 (m)-15 or (m)-16 of Regulations 94, article 25 (m)-15 or (m)-16 of Regulations 101, §§ 19.23 (m)-15 or 19.23 (m)-16 of Regulations 103, and §§ 22.23 (m)-15 or 22.23 (m)-16 of Regulations 105 and 106.

Example. A, who makes his returns on the calendar year basis, purchased property in 1933 for $50,000. He subsequently expended $20,000 for improvements in 1936 and $6,000 for repairs in 1939. For purposes of this example, the adjustments required for depreciation, the adjusted basis, and the amount, if any, allocable to capital account is the property is $15,000. If A sells the property in 1942 for $5,000, the gain shall be $5,000, the amount of such gain to be taken into account in computing net income for the taxable year in which the sale is made.

Capital expenditures and carrying charges with respect to property of either real or personal, improved or unimproved, and whether productive or unproductive, such as taxes and interest, as to which under these regulations there is an election to treat either as chargeable to capital account or as an allowable deduction in the manner provided in §§ 29.24 (m)-5 (e) but for which there have been taken no deductions by the taxpayer in determining net income for the taxable year, or a prior taxable year, are properly chargeable to capital account. (See § 29.24-5.) The term "taxes" for this purpose, includes duties and excise taxes (see § 29.23 (o)-9), but does not include income taxes.

The cost or other basis must also be decreased by the amount of the deduction for exhaustion, wear and tear, obsolescence, amortization, and depletion to the extent such deductions have in respect to any period since February 28, 1913, been allowed (but such decrease shall not be less than the amount of deductions allowable) under chapter 1 or prior income tax laws. The adjustment required for any taxable year or period is the amount allowed or the amount allowable for such year or period under the law applicable thereto, whichever is the greater amount. A taxpayer is not permitted to take advantage in a later year of his prior failure to take any depreciation allowance or of his action in taking an allowance plainly inadequate under the known facts in prior years.

The determination of the amount properly allowable shall, however, be made...
on the basis of facts reasonably known to exist at the end of such year or period.

The aggregate sum of the greater of such annual amounts is the amount by which the cost or other basis of the property shall be adjusted. For example, the case of Corporation A discloses the following facts as of January 1, 1942:

<table>
<thead>
<tr>
<th>Year</th>
<th>Adjusted</th>
<th>Allowable</th>
<th>Amortizable bond premium</th>
</tr>
</thead>
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The depreciation allowed but not less than the amount allowable in this example as of January 1, 1943, is $4,000, and the cost or other basis of the property is to be adjusted by that amount. The deductions by which the cost or other basis is to be decreased shall include deductions allowed under section 116 (b) (2) of the Revenue Act of 1932, the Revenue Act of 1934, the Revenue Act of 1938, and the Internal Revenue Code, for the taxable year 1932 and subsequent taxable years, but any amount by which the diminution in respect of depletion for taxable years prior to 1932 shall not exceed a depletion deduction computed without reference to discovery value in the case of mines, or without reference to discovery value or a percentage of income in the case of oil and gas wells.

The cost or other basis shall also be decreased by the exhaustion, wear and tear, obsolescence, amortization, and depletion sustained in respect of any period prior to March 1, 1913.

In the case of stock, the cost or other basis must be determined by the amount of distributions previously made which, under the law applicable to the year in which the distribution was made, either were tax-free or were applicable in reduction of basis (not including distributions made by a corporation, which was classified as a personal service corporation under the provisions of the Revenue Act of 1918 or 1921, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or 1921).

Example. A, who makes his returns upon the calendar year basis, purchased stock in 1923 for $8,000. In 1924 a distribution of $9,000 paid out of earnings and profits of the corporation accumulated prior to March 1, 1913. The adjusted basis for determining the gain or loss from the sale or other disposition of the stock in 1943 is $5,000 less $2,000, or $3,000, and the amount of the gain or loss from the sale or other disposition of the stock is the difference between $9,000 and the amount realized from the sale or other disposition. But see section 117.

In the case of the stock of United States shareholders in a foreign personal holding company the cost or other basis must be adjusted also to the extent provided in section 337 (f).

Adjustments must always be made to eliminate double deductions or their equivalent. Thus, in the case of the stock of a subsidiary company, the basis thereof must be properly adjusted for the amount of the subsidiary company's losses for the years in which consolidated returns were made.

In determining basis, and adjustments to basis, the principles of estate apply, as elsewhere under the Internal Revenue Code. For adjustment to basis of bonds on account of amortizable bond premium, see §§ 29.125-1 to 29.125-2, inclusive.

§ 29.113 (b) (1)-2 Adjusted basis; cancellation of indebtedness. In addition to the adjustments provided in section 113 (b), (1) and § 29.113 (b) (1)-1, which are required to be made with respect to the cost or other basis of property, a further adjustment shall be made in any case in which there shall have been a cancellation or reduction of indebtedness in any taxable years prior to March 1, 1932. Such further adjustment shall be made in the following manner and order:

(a) In the case of indebtedness incurred to purchase specific property (other than inventory or accounts receivable) whether or not a lien is placed against such property securing the payment of all or part of such indebtedness, the indebtedness shall have been canceled or reduced in any such proceeding, the cost or other basis of such property shall be decreased (but not below its fair market value) by the amount by which the indebtedness so incurred with respect to specific property shall have been canceled or reduced;

(b) In the case of specific property (other than inventory or notes or accounts receivable) against which, at the time of the cancellation of the indebtedness, there is a lien (other than a lien securing indebtedness incurred to purchase such property) the cost or other basis of such property shall be decreased (but not below its fair market value) by the amount by which the indebtedness secured by such lien shall have been canceled or reduced;

(c) Any excess of the total amount by which the indebtedness shall have been so canceled or reduced in such proceeding over the sum of the adjustments made under (a) and (b) shall next be applied to reduce the cost or other basis of the property of the debtor (other than inventory and notes and accounts receivable, but including property covered by (a) and (b)) as follows: The cost or other basis of each unit of property shall be decreased (but not below its fair market value) in an amount equal to such proportion of such excess as the remaining basis of each such unit bears to the sum of the adjusted bases of such units.

The process shall be repeated until the cost or other basis of each unit of the property covered by (a), (b), (c), and (d) shall have been reduced to its fair market value.

(e) Any excess of the total amount by which the indebtedness shall have been so canceled or reduced over the sum of the adjustments made under (a), (b), (c), and (d) shall next be applied to reduce the cost or other basis of inventory and notes and accounts receivable, as follows:

The process shall be repeated until the adjusted bases of inventory and notes receivable and accounts receivable are reduced to their fair market value, or the amount by which the indebtedness shall have been canceled or reduced in such proceeding is exhausted, taking into account in the successive steps only those units of property having, after the preceding adjustment, a remaining basis greater than their fair market value.

For the purposes of this section:

(1) Basis shall be determined as of the date of entry of the order confirming the plan, composition or arrangement under which such indebtedness shall have been canceled or reduced;

(2) Except where the context otherwise requires, property means all of the debtor's property, other than money;

(3) No adjustment shall be made by virtue of the cancellation or reduction of an accrued interest uncollectible which shall not have resulted in a tax benefit in any income tax return;

(4) The phrase "indebtedness incurred to purchase" includes (i) indebtedness for money borrowed and applied in the purchase of property and (ii) an existing indebtedness secured by a lien against the property which the debtor,
as purchaser of such property, has assumed to pay; and

(5) The term "fair market value" has reference to such value as of the date of entry of the order confirming the plan, composition or arrangement under which such indebtedness shall have been canceled or reduced.

Any determination of value in a proceeding under the Bankruptcy Act, as amended, shall not constitute a determination of fair market value for the purposes of this section.

The basis of any of the debtor's property which shall have been transferred to a person required to use the debtor's basis in whole or in part shall be determined in accordance with the provisions of this section.

§ 29.113 (b) (1)–3 Adjusted basis; cancellation of indebtedness; special cases.

If the taxpayer and the Commissioner agree, the basis of the taxpayer's property may be adjusted in a manner different from that set forth in § 29.113 (b) (1)–2. Variations from such rule may, in rare cases, involve adjusting the basis of any part of the taxpayer's property or adjusting the basis of all the taxpayer's property, according to a fixed allocation. Agreement between the taxpayer and the Commissioner as to any allocation shall be made after first making in respect of such substituted basis proper adjustments of a similar nature in respect of the period during which the property was held by the transferor, donor, or grantor, or during which the other property was held by the person for whom the basis is to be determined. A similar rule shall be applied in the case of a series of substituted bases.

§ 29.113 (b) (2)–1 Substituted basis.

Whenever it appears that the basis of property in the hands of the taxpayer is a substituted basis, as defined in section 113 (b) (2), the adjustments indicated in § 29.113 (b) (1)–1 shall be made after first making in respect of such substituted basis proper adjustments of a similar nature in respect of the period during which the property was held by the transferor, donor, or grantor, or during which the other property was held by the person for whom the basis is to be determined. In addition, whenever it appears that the basis of property in the hands of the taxpayer is a substituted basis, the adjustments indicated in §§ 29.113 (b) (1)–2, 29.113 (b) (3)–1, and 29.113 (b) (3)–2 shall also be made, whenever necessary, after first making in respect of such substituted basis proper adjustments of a similar nature in respect of the period during which the property was held by the transferor, donor, or grantor. Similar rules shall also be applied in the case of a series of substituted bases.

Example. A, who makes his returns upon the calendar year basis, in 1927 purchased the Y Building and subsequently gave it to his son B. B entered into the following for the Y Building in a tax-free exchange, and then gave the Y Building to his wife C. In determining the adjusted basis of the property owned by C, it is required to reduce the basis of the building by deductions for depreciation which were subsequently made, but not the amount allowable to A and B upon the Y Building and to C upon the Y Building, in addition to the depreciation allowed (but not less than the amount allowable to C) in respect of such substituted bases.

Any determination of value in a proceeding under the Bankruptcy Act, as amended, shall not constitute a determination of fair market value for the purposes of this section.

§ 29.113 (b) (3)–1 Adjusted basis; discharge of corporate indebtedness.

general rule. The adjustments provided in section 113 (b) (1) and § 29.113 (b) (1)–1 which are required to be made with respect to the cost or other basis of property, a further adjustment shall be made in any case in which there shall have been an exclusion from gross income under section 22 (b) (9) on account of the discharge of indebtedness of a corporation during the taxable year in which such discharge occurred.

(c) Any excess of the total amount excluded from gross income under section 22 (b) (9) over the sum of the adjustments made under (a) and (b) shall next be applied to reduce the cost of other basis of the property of the debtor (other than inventory and notes and accounts receivable, but including property covered by (a) and (b)) as follows: The cost or other basis of such property shall be decreased but the amount of the decrease shall not be more than the amount of the adjusted basis (without reference to this section) in such case may be, bears to the sum of the adjusted basis (without reference to this section) of each such unit of property bears to the sum of adjusted bases (without reference to this section) of the property of the debtor (other than inventory and notes and accounts receivable); and

(d) Any excess of the total amount excluded from gross income under section 22 (b) (9) over the sum of the adjustments made under (a), (b), and (c) shall next be applied to reduce the cost or other basis of inventory and notes and accounts receivable, as follows: The cost or other basis of inventory or notes or accounts receivable, as the case may be, shall be decreased but the amount of the decrease shall not be more than the amount of the adjusted basis (without reference to this section) of such excess as the adjusted basis (without reference to this section) of each such unit of property bears to the sum of adjusted bases (without reference to this section) of the property of the debtor (other than inventory and notes and accounts receivable, as the case may be, bears to the sum of
the adjusted bases of such inventory and notes and accounts receivable.

For the purposes of this section:

(1) Exception to otherwise requires, property means all of the debtor's property, other than money;

(2) The phrase "indebtedness incurred to purchase" includes (i) indebtedness for money applied in the purchase of property and (ii) an existing indebtedness secured by a lien against the property which the debtor, as purchaser of such property, has assumed to pay;

(3) The phrase "amount excluded from gross income under section 22(b) (9)" means the amount of income excluded under that section reduced by any deduction disallowed under that section for unamortized discount;

(4) Adjustments to basis shall be made:

(i) In the case of property owned on the first day of the taxable year, as of that day;

(ii) In the case of property acquired after the first day of the taxable year, as of the day so acquired;

regardless of the time such property was subsequently sold, exchanged, or otherwise disposed of by the taxpayer;

(5) Where a reduction in basis of indebtedness is accomplished by a transfer of the taxpayer's property in kind, the difference between the amount of the obligation discharged and the fair value of the property transferred is the amount which may be applied in reduction of basis;

(6) Regardless of the amount excluded by the taxpayer from his gross income under section 22(b) (9) and so stated on Form 982, the maximum amount by which basis may be reduced in respect of the discharge of any indebtedness is the amount of income resulting from the discharge of such indebtedness.

Example (1). On January 1, 1942, the N Corporation owned an office building, which it sold in March 1942. In June 1942 it purchased a stock of Officers Company. In October 1942 the N Corporation bought in its outstanding bonds at less than their face value. Assuming that there is a proper exclusion from gross income under section 22(b) (9), the basis of each bond shall be adjusted under section 113(b)(3) for the taxable year 1942. (But see §29.113(b) (2).)

Example (2). The M Corporation has outstanding an issue of A bonds which it had sold at a premium and an issue of B bonds which it had sold at a discount. In July 1942 the M Corporation purchased such outstanding bonds for less than face value. The amount of income attributable to the discharge of the A bonds is $1,000 and the amount of unamortized premium is $200. The amount of income attributable to the discharge of the B bonds is $1,000 and the amount of unamortized discount is $500.

The M Corporation under section 22(b) (9) elects to have excluded from gross income the amount of income attributable to the discharge of such bonds which it had sold at a premium. The adjustment in basis of the property of the M Corporation shall not exceed $2,150. If the M Corporation elects only with respect to the A bonds, the total reduction in basis shall not exceed $1,200 (or $950 if the election is with respect to the A bonds, the total portion contained an amount of $600 with respect to the A bonds, the total reduction in basis may nevertheless be $1,200 (or $950 if the election is with respect to the B bonds).

§ 29.113(b)(3)–2. Adjusted basis, discharge of corporate indebtedness; special cases. Section 29.113(b)(3)–1 prescribes the general rule to follow in adjusting the basis of property where there is a proper exclusion from gross income under section 22(b) (9). The taxpayer may, however, have the basis of its property adjusted in a manner different from that set forth in §29.113(b)(3)–1 upon a proper showing to the satisfaction of the Commissioner. Variations from such general rule may, for example, involve adjusting the basis of only part of the taxpayer's property or adjusting the basis of all the taxpayer's property, according to a fixed allocation. A request for variations from the general rule shall be filed by the taxpayer with its return for the taxable year in which the discharge of indebtedness has occurred. Agreement between the taxpayer and the Commissioner regarding such variations from such general rule shall be effected only by a closing agreement entered into under the provisions of section 7060. If no agreement is reached between the taxpayer and the Commissioner as to variations from the general rule prescribed in §29.113(b)(3)–1, then the consent filed on Form 982 shall be deemed to be a consent to the application of the special general rule prescribed in §29.113(b)(3)–1. The tax treatment of such property for the purposes of capital gains and losses shall be determined in accordance with the provisions of section 23(a).
(3) Percentage depletion for oil and gas wells. In the case of oil and gas wells the allowance for depletion under section 23 (m) shall be 21 3/4 per cent of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred in respect of the property. Such allowance shall not exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property, except that no case shall the depletion allowance under section 23 (m) be less than it would be if computed without reference to this paragraph.

(4) Percentage depletion for cool, fluor spar, ball and sagger clay, rock asphalt, and metal mines. The allowance for depletion under section 23 (m) shall be, in the case of cool mines, 5 per cent, in the case of metal mines, fluor spar, ball and sagger clay or rock asphalt mines, 10 per cent, and in the case of sulphur mines or deposits, 23 per cent, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred in respect of the property. Such allowance shall not exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property, except that no case shall the depletion allowance under section 23 (m) be less than it would be if computed without reference to this paragraph.

§ 39.114-1 Basis for allowance of depreciation and depletion. The basis upon which exhaustion, wear and tear, obsolescence, and depletion will be allowed is the property as it is described and held for use or consumption as is provided in section 113 (a), adjusted as provided in section 113 (b), for the purpose of determining the gain from the sale or other disposition of such property, except as provided in § 29.23 (m)–4, relating to depletion based on discovery value, in § 29.23 (m)–4, relating to percentage depletion in the case of oil and gas wells, and in § 29.23 (m)–5, relating to percentage depletion in the case of coal mines, metal mines, fluor spar mines, ball and sagger clay mines, or rock asphalt mines, and sulphur mines or deposits.

Sect. 115. Distributions by corporations [as amended by Revenue Act of 1898; Act of March 2, 1913; Act of March 4, 1919; Act of June 17, 1919; Acts of 1921; Rev. Act of 1936; sec. 501 (a), 2d Rev. Act, 1940; sec. 146 (a), 147, 163, 166 (a) (b), Rev. Act, 1942].

(a) Definition of dividend. The term "dividend" means in case of a corporation (except in section 201 (e) (5), section 206 (e) (11), and section 207 (a) (2) and (b) (5) where the reference is to subsidiaries of insurance companies paid to policyholders) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed after the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made. Such term also means any distribution of property, whether in money or in other property, made by a corporation which, under the law applicable to the taxable year in which the distribution is made to the holding company or any other corporation, was for the purpose of converting the property of such company, which for the taxable year in respect of which the distribution is made under section 904 (a) or section 604 (a) or a corresponding provision of a prior income tax law, is a personal holding company of the corporation, under the law applicable to such taxable year, or (b) Source of distributions. For the purpose of this chapter every distribution by a corporation is, at the election of any of the shareholders (whether exercised before or after the declaration thereof), payable either (A) in stock or in exchange for its stock, of a class which if distributed without election would be exempt from tax under paragraph (b) (4) (B) in money, or (C) in property (including its stock or in rights (including its stock or in rights to acquire its stock, of a class which if distributed without election would be exempt from tax under paragraph (b) (1)), then the distribution shall constitute a taxable dividend to the extent of all shareholders, regardless of the medium of distribution.

(b) Redemption of stocks. If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at any time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

§ 23.116-1 Provisions applicable to a corporation. The provisions of section 910 (a) (1) and (2) as amended by Revenue Act of 1934, 48 Stat. 712, and a corresponding provision of a prior Revenue Act.

As used in this subsection the term "stock or securities" includes rights to acquire stock or securities.

(1) Definition of partial liquidation. As used in this subsection the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or in a series of distributions of its stock in complete liquidation or in complete cancellation or redemption of all or a portion of its stock.

(2) Valuation of dividend. If the whole or any part of a dividend is paid to a shareholder in any medium other than money then such dividend shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder.

(3) Consent distributions. For taxability as dividends of amounts agreed to be included in gross income by shareholders' consents, see section 59.

(a) Election of shareholders as to medium of payment. When a corporation is, at the election of any of the shareholders (whether exercised before or after the declaration thereof), payable either (A) in stock or in exchange for its stock, of a class which if distributed without election would be exempt from tax under paragraph (b) (4) (B) in money, or (C) in property (including its stock or in rights to acquire its stock, of a class which if distributed without election would be exempt from tax under paragraph (b) (1)), then the distribution shall constitute a taxable dividend to the extent of all shareholders, regardless of the medium of distribution.

(1) Election of shareholders as to medium of payment. When a corporation is, at the election of any of the shareholders (whether exercised before or after the declaration thereof), payable either (A) in stock or in exchange for its stock, of a class which if distributed without election would be exempt from tax under paragraph (b) (4) (B) in money, or (C) in property (including its stock or in rights to acquire its stock, of a class which if distributed without election would be exempt from tax under paragraph (b) (1)), then the distribution shall constitute a taxable dividend to the extent of all shareholders, regardless of the medium of distribution.
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Any distribution by a corporation out of earnings or profits accumulated prior to March 1, 1913, or out of its income exempted from tax by statute, on or before the close of the taxable year is taxable to the distributee as such distribution is includible in gross income for the purpose of determining earnings and profits for the year in which the distribution is made.

§ 29.115-3 Earnings or profits. In determining the amount of earnings or profits which, if acquired prior to March 1, 1913, or accumulated prior to March 1, 1913, due consideration must be given to the facts, and, while mere bookkeeping entries increasing or decreasing surplus will not be considered, the amount of the earnings or profits in any case will be dependent upon the method of accounting properly employed in computing net income. For instance, a corporation keeping its books on a cash receipts and disbursements basis may not use the accrual basis in determining earnings and profits; a corporation publishing its statements of the settlement basis as provided in section 46 shall, with respect to the installment transactions, compute earnings and profits on such basis; a finance company subject to taxation under section 204 shall exclude from earnings and profits that portion of any premium which is unearned under the provisions of section 204 (b), and which is segregated accordingly in the unearned premium reserve. If the earnings or profits of a corporation are to be considered in the computation of net income, the only depletion or depreciation is a factor in determining the amount of earnings or profits accumulated since February 28, 1913, or which is segregated as a cash reserve in the hands of a corporation. The provisions of this section may be illustrated by the following example:

Example. Oil producing property which A had acquired in the year 1909 was transferred to the Y Corporation in December, 1936, in exchange for all of its capital stock. The fair market value of the property on the date of the transfer was $277,000. The Y Corporation, after four years' operations, effected in 1942 a cash distribution to A in the amount of $315,000. In determining the extent to which the earnings and profits of the Y Corporation available for dividend distributions have been increased as the result of production and sale of oil, the depletion to be taken into account shall be computed in accordance with the provisions of section 29.115-4, as established in the net taxable income of 1938 regardless of the fair market value of the property or of the stock issued in exchange therefor.

A loss sustained for a year prior to the taxable year does not affect the earnings or profits of the taxable year. However, in determining the earnings or profits accumulated prior to February 28, 1913, the excess of a loss sustained for a year subsequent to February 28, 1913, over the undistributed earnings or profits accumulated since February 28, 1913, and which is segregated accordingly in the unearned premium reserve, shall be treated as a portion of the earnings or profits accumulated prior to February 28, 1913, to the extent of such excess.

With respect to the effect on the earnings or profits of a corporation prior to February 28, 1913, of distributions made on or after January 1, 1916, and prior to August 6, 1917, out of earnings or profits accumulated prior to March 1, 1913, with a distribution declared to be out of earnings or profits accumulated prior to March 1, 1913, see section 31 (b) of the Revenue Acts of 1916, as amended by sections 1211 of the Revenue Acts of 1917.

§ 29.115-4 Distributions other than a dividend. Under section 115 (d), any distribution (including a distribution out of earnings or profits accumulated before March 1, 1913) other than:

(a) A dividend (see §§ 29.115-4 and 29.115-2),

(b) A distribution out of increase in value of property accrued prior to March 1, 1913 (see § 29.111-1),

(c) A distribution of partial or complete liquidation (see §§ 29.115-5), or

(d) A distribution which, under section 115 (1) (f), is not treated as a dividend (see § 29.115-7),

shall be applied against and reduce the adjusted basis of the stock provided in section 113 (b) of the Revenue Acts of 1916, as applicable to the recipient if, and to the extent that, such distribution exceeds such basis. The provisions of this section are applicable to such distributions received by one corporation from another corporation.

Example. In 1942 the M Corporation purchased certain shares of stock in the O Corporation for $10,000. During that year the M Corporation received a distribution from the O Corporation of $2,000 paid out of earnings or profits of the O Corporation accumulated prior to March 1, 1913. This distribution must be applied by the M Corporation against the basis of its stock in the O Corporation reducing such basis to $8,000. The $2,000 does not constitute a part of the earnings or profits of the M Corporation.

If the M Corporation subsequently sells the stock of the O Corporation for $20,000, it realizes a gain of $10,000, which constitutes a gain on the sale of capital stock in which the stock is sold. If the distribution had amounted to $18,000, the gain of $4,000 from the sale would be taxable to the M Corporation and would have constituted a part of the earnings or profits of that corporation for the year in which the distribution was made.

§ 29.115-5 Distributions in liquidation. Amounts distributed in complete liquidation of a corporation are to be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation are to be considered as in part or full payment in exchange for the stock so canceled or redeemed. The gain or loss to a shareholder from a distribution in liquidation shall be determined, as provided in section 111 and § 29.111-1, by comparing the amount of the distribution with the cost or other basis of the stock provided in section 112; but the gain or loss will be recognized only to the extent provided in section 112, and shall be subject to the conditions and limitations provided in section 117.

For the purposes of this section, amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one or a series of distributions in complete cancellation or redemption of all or a portion of its stock. A complete cancellation or redemption of a part of a corporation's stock may be accomplished, for example, by the complete retirement of a certain fraction of the shares of a particular preference or series, or by taking up all the old shares of a particular preference or series and issuing new shares to replace a portion thereof, or by the complete retirement of any part of the stock, whether or not prorated among the share-holders.

In the case of amounts distributed in partial liquidation, the part of such distribution which is not eligible to capital account shall not be considered a distribution of earnings or profits within the meaning of section 115; but the purpose of determining the availability of subsequent distributions by the corporation. (See §§ 29.27 (p)–1 and 29.115–11.)

For the purposes of the last sentence of section 115 (c), a liquidation may be treated prior to liquidation or liquidation of the liquidating corporation but no liquidation is completed until the liquidating corporation and the receiver on the assets in liquidation are finally divested of all the property (both tangible and intangible).

For the purposes of this section the determination of whether a foreign cor-
poration was a foreign personal holding company with respect to a taxable year beginning on or after February 28, 1937, shall be made under section 313 of the Revenue Act of 1936 and the regulations thereunder.

The provisions of this section may be illustrated by the following examples:

Example (1). A, an individual who makes his income tax returns on the calendar year basis, owns 20 shares of stock of the P Corporation, a domestic corporation, 10 shares of which were acquired in 1931 at a cost of $1,500, and the remainder of 10 shares in December 1941 at a cost of $3,500. He receives in April 1942 $250 per share in complete liquidation, or $2,500 on the 10 shares acquired in 1931, and $2,500 on the 10 shares acquired in December 1941. The gain of $400 on the shares acquired in 1941 should be deducted in computing A's net income to the extent of 100 percent, or $400. (See section 117.)

Example (2). A, an individual who makes his income tax returns on the calendar year basis, owns 100 shares of preferred stock of the Z Corporation, 10 shares of which were acquired in 1933 for $1,700 and 90 shares of which were acquired in January 1942 for $1,200. In May 1942 the corporation in a transaction qualifying as a partial liquidation redeemed the entire issue of preferred stock for $3,500 per share, and the amount of the loss of $150 per share on the shares acquired in 1933 should be deducted in computing A's net income to the extent of 100 percent, or $150. The gain of $400 on the shares acquired in January 1942 should be included in A's gross income to the extent of 100 percent, or $400. (See section 117.)

§ 29.115-8 Distributions from depletion or depreciation reserves. A reserve set up out of gross income by a corporation and maintained for the purpose of making good any loss of capital assets on account of depletion or depreciation is not a part of surplus out of which dividends may be distributed. A distribution made from a depletion or depreciation reserve based upon a valuation as of March 1, 1913, which is in excess of the depletion reserve based upon cost, will not be considered as having been paid out of earnings or profits of the corporation and maintained for the purpose of making good any loss, if distributed shall be applied against and reduce the cost or other basis of the stock upon which declared. (See § 29.111-1.)

No distribution, however, can be made in one medium unless the shares of stock or any other property or (b) in stock or in stock rights which, if distributed without an election, would not otherwise be treated as a dividend shall not be so treated merely because such distribution was made out of treasury stock or consisted of rights to acquire treasury stock.

§ 29.115-9 Distribution in redemption of stock taxable as dividend. If a corporation cancels or redeems all of its stock (whether or not such redemption is a part of a plan of reorganization), gain or loss that is not recognized (or was recognized only to the extent that it represents a distribution of a taxable dividend), then proper adjustment and allocation of the earnings or profits of the transferor shall be made as between the transferor and transferee corporations.

The general rule provided in section 115 (b) that every distribution is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits, does not apply to:

Determinations and adjustments under this section are made in the cases of (a) the redemption of all the stock except the nonparticipating preferred stock of the Z Corporation, (b) the distribution of a dividend, and (c) the distribution of all the stock of a particular shareholder, so that the shareholder ceases to be interested in the affairs of the corporation, does not affect a distribution of a taxable dividend.

A bona fide distribution in complete cancellation or redemption of all of the stock of a corporation, or one of a series of bona fide distributions in complete cancellation or redemption of all of the stock of a corporation, is not essentially equivalent to the distribution of a taxable dividend. If a distribution is made pursuant to a corporate resolution resolution, redemption of all of the stock of a particular shareholder, so that the shareholder ceases to be interested in the affairs of the corporation, does not effect a distribution of a taxable dividend.
organization, to its shareholders of stock or securities in such corporation or in another corporation a party to the reorganization:

1. In any taxable year beginning before January 1, 1934, without the surrender by the distributees of stock or securities in such corporation (see section 112 (g) of the Revenue Act of 1933);

2. In any taxable year beginning before January 1, 1939, or on or after such date in exchange for its stock or securities (see section 112 (b) (3)) if no gain to the distributees from the receipt of such stock or securities was recognized by law.

(b) The distribution in any taxable year (beginning before January 1, 1939, or on or after such date) of stock or securities, or other property or money, to a corporation in complete liquidation of another corporation, under the circumstances described in section 112 (b) (6) of the Revenue Act of 1936, or of the Revenue Act of 1938, or of the Internal Revenue Code.

(c) The distribution in any taxable year (beginning after December 31, 1938) of stock or securities, or other property or money, in the case of an exchange distribution described in section 371 (relating to exchanges and distributions in obedience to orders of the Securities and Exchange Commission), if no gain to the distributees from the receipt of such stock, securities, or other property or money was recognized by law.

(d) A stock dividend which was not subject to tax in the hands of the distributees because it did not constitute income to him within the meaning of the sixteenth amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or the corresponding provision of a prior Revenue Act.

A distribution described in paragraph (a), (b), (c), or (d) above does not diminish the earnings or profits of any corporation. In such cases, the earnings or profits remain intact and available for distribution in subsequent years in complete liquidation of another corporation making the distribution or by another corporation to which the earnings or profits are transferred under such reorganization or other exchange. In the case, however, of amounts distributed in liquidation (other than a tax-free liquidation or reorganization described in paragraphs (a), (b), (c), or (d) above) the earnings or profits of the corporation making the distribution are diminished by the portion of such distribution properly chargeable to earnings or profits accumulated after February 28, 1913, after first deducting from the amount of such distribution the portion thereof allocable to capital account.

For the purposes of this section, the term "tax-free liquidation or reorganization" shall, for any taxable year beginning before January 1, 1934, have the meanings assigned to such terms in section 112 of the Revenue Act of 1934, or for a taxable year beginning after December 31, 1933, and before January 1, 1935, have the meanings assigned to such terms in section 112 of the Revenue Act of 1934; for any taxable year beginning after December 31, 1933, and before January 1, 1934, have the meanings assigned to such terms in section 112 of the Revenue Act of 1936; and for any taxable year beginning after December 31, 1937, and before January 1, 1939, have the meanings assigned to such terms in section 112 of the Revenue Act of 1938.

§ 29.115-12 Effect on earnings and profits of gain or loss realized after February 28, 1913. In order to determine the effect on the earnings and profits of gain or loss realized from the sale or other disposition of property (after February 28, 1913) of property by a corporation, section 115 (d) prescribed certain rules for (1) the computation of the total earnings and profits of the corporation, or in the case of a liquidation, the earnings and profits accumulated in investing capital; and (2) the computation of earnings and profits of the corporation for any period beginning after February 28, 1913, of most frequent application requiring the use of adjustments in the source of dividend distributions. Such rules are applicable whenever under any provision of chapter 1 or 2 it is necessary to compute either the earnings and profits of the corporation or the earnings and profits for any period beginning after February 28, 1913. For example, since the earnings and profits accumulated after February 28, 1913, of the earnings and profits of the taxable year, are earnings and profits for a period beginning after February 28, 1913. Under (1) such gain or loss is determined by using the adjusted basis (under the rules of section 115 (f)) for determining gain, but disregarding value as of March 1, 1931. Under (2) there is used such adjusted basis for determining gain, with the value as of March 1, 1931, whenever applicable. In both cases the rules are the same as those governing depreciation and depletion in computing earnings and profits (see § 29.115-5). Under both (1) and (2) the adjusted basis is subject to the limitations of the third sentence of section 115 (d) requiring the use of adjustments proper in determining earnings and profits. Different results may differ under (1) and (2) of section 115 (d) depending upon the basis to which the adjustments are to be made. If the application of (2) of the first sentence of section 115 (d) results in a loss and if the application of (1) of such sentence to the same transaction reaches a different result, then the loss under (2) will be subject to the adjustment therefor required by section 115 (d) (2). (See § 29.115-14.)

The gain or loss so realized increases or decreases the earnings and profits to, but not beyond, the extent to which such gain or loss was recognized in computing net income allocable to the year in which such sale or disposition was made. As used in this paragraph the term "recognized" has reference to that kind of realized gain or loss which is recognized for income tax purposes by the statute applicable to the year in which such gain or loss is realized. For example, see section 112. A loss (other than a wash sale loss with respect to which a deduction is disallowed under the provisions of section 115 or corresponding provisions of prior revenue laws) may be recognized though not allowed as a deduction (by reason, for example, of the operation of sections 24 (b) and 177 and corresponding provisions of prior revenue laws) but only if it is shown that it is not allowed does not prevent decrease in earnings and profits by the amount of such disallowed loss. Wash sale losses, however, disallowed under section 115 and corresponding provisions of prior revenue laws, are deemed nonrecognized losses and do not reduce earnings or profits. The "recognized" gain or loss for the purpose of computing earnings and profits is determined by applying the recognition provisions to the realized gain or loss computed under the provisions of section 115 (d) as distinguished from the rules governing the loss used in computing net income. The application of this paragraph may be illustrated by the following examples:

Example (1). The X Corporation on January 1, 1910, owned stock in the Y Corporation which it had acquired in an exchange transaction in December 1911. In an exchange transaction in which no gain or loss was recognized, the X Corporation transferred to the Y Corporation the property by it for the stock in the Y Corporation was $500,000. The market value of the stock in the X Corporation when received by the X Corporation was $500,000. On April 9, 1942, the X Corporation made a cash distribution of $500,000 and, except for the possible effects of the transaction in 1911, had no earnings or profits accumulated after February 28, 1913, and had no earnings or profits for the taxable year. The amount of $500,000 representing the excess of the fair market value of the stock of the Y Corporation over the adjusted basis of the property exchanged therefor was not recognized gain to the X Corporation under the provisions of section 112. Accordingly, the earnings and profits of the X Corporation are not increased by $500,000, the amount of the gain realized but not recognized. The distribution was not a taxable dividend. The basis in the hands of the X Corporation of the property acquired by it from the X Corporation is $500,000. If such property is thereafter sold by the X Corporation, gain or loss will be computed on such basis of $500,000 and earnings and profits will be increased or decreased accordingly.

Example (2). On January 2, 1910, the M Corporation acquired property at a cost of $1,000. On March 1, 1915, the fair market value of such property in the hands of the M Corporation was $3,000. On December 31, 1942, the M Corporation transfers such property to the N Corporation in exchange for $1,000 in cash and all of the property of the N Corporation of a fair market value of $1,100. For the purpose of computing the total earnings and profits of the M Corporation for the taxable year ending is $2,000 (the sum of $1,000 in cash and stock worth $1,100 minus $1,200, the adjusted basis for computing gain, determined at the date of the property transferred to the N Corporation). The total earnings and profits of the N Corporation for the taxable year ending is $1,100 (the sum of which is recognized under section 112 (e), since this was the amount of money received, although for the purpose of computing net income the gain is only $100 (the sum of
$1,000 in cash and stock worth $1,100, minus $2,000, the adjusted basis for computing gain determined by § 113 (a) (12). Such earnings and profits will therefore be increased by $1,000. In computing the earnings and profits of the X Corporation for any taxable year ending after February 28, 1913, however, the gain arising from the transaction, like the taxable gain, is only $800, all other deductions under sections 112 (c), the money received being in excess of such amount. Such earnings and profits will therefore be increased by $800, a result of the transaction. For increase in that part of the earnings and profits consisting of increase in value of property accrued before, but realized on or after, March 1, 1913, see § 29.115-11.

Example (1). On January 2, 1913, the X Corporation purchased on the installment plan for $25,000 in cash and all of the stock of the Y Corporation, one of its first or receiving corporations, in exchange for $25,000 in cash and all of the stock of the X Corporation. The original cost of the Y Corporation's stock to the X Corporation was, however, $200,000, but having an adjusted basis (by reason of taking percentage depletion) of $100,000 for determining gain in computing net income. However, the adjusted basis of such property to be used in computing gain or loss for the purpose of computing earnings and profits is, because of the provisions of the third sentence of section 115 (1), $150,000. On such day the original cost of the Y Corporation's stock to the X Corporation was, however, $200,000, but having an adjusted basis of $100,000 for purposes of valuing property to the S Corporation in exchange for $25,000 in cash and all of the S Corporation stock, which has been applied in computing net income of the R Corporation has realized a gain of $25,000 as a result of this transaction, all of which is deferred under section 115 (12) (c) for purposes of determining earnings and profits, however, will be $125,000 (though only $100,000 for the purpose of computing net income), computed as follows:

<table>
<thead>
<tr>
<th>Basis of property transferred</th>
<th>$200,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less money received on exchange</td>
<td>$2,000</td>
</tr>
<tr>
<td>Plus gain or minus loss recognized on exchange</td>
<td>None</td>
</tr>
<tr>
<td>Bases of stock transferred</td>
<td>$178,000</td>
</tr>
<tr>
<td>Less adjustment (see above) used in determining adjusted basis of property transferred</td>
<td>$5,000</td>
</tr>
<tr>
<td>Adjusted basis on stock</td>
<td>$125,000</td>
</tr>
</tbody>
</table>

If, therefore, the R Corporation should subsequently sell the S Corporation stock for $105,000, a loss of $25,000 will again be realized for the purpose of computing earnings and profits, all of which will be recognized and will be applied to decrease the earnings and profits of the R Corporation.

The third sentence of section 115 (1) provides that after the adjustments, prescribed in section 113, to the bases indicated in paragraph (1) or (2) of the first sentence, as the case may be, of section 115 (1), differ from the adjustment formerly recognized for the purpose of determining earnings or profits.

The adjustments provided by the third sentence of section 115 (1) reflect the treatment provided by § 29.115-3 relative to cases where the deductions for depletion and depreciation in computing net income differ from the deductions proper for the purpose of computing earnings and profits. The effect of such third sentence may be illustrated by the following examples:

Example (1). The X Corporation purchased on January 2, 1913, an oil lease at a cost of $7,000 by which the percentage depletion for the years 1931 and 1932 was increased by $7,000, or $7,250, and the earnings and profits of the X Corporation were increased by $7,250, but not by $7,750. The difference of $1,750 is equal to the amount by which the percentage depletion for the year 1932 (§ 29.115-3) exceeded the cost of the lease on March 1, 1913, and by reason of taking percentage depletion (§ 115 (1)) prescribed in section 112, is allocable between the old stock and the new stock in the ratio of $800 to $1,000. For the purpose of computing net income, the R Corporation has realized a gain of only $2,250 as a result of this transaction, all of which is deferred under section 115 (12) (c) for purposes of determining earnings and profits, however, will be $2,250 (though only $2,000 for the purpose of computing net income), computed as follows:

<table>
<thead>
<tr>
<th>Basis of property transferred</th>
<th>$2,250</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less money received</td>
<td>$2,000</td>
</tr>
<tr>
<td>Plus gain or loss recognized on exchange</td>
<td>None</td>
</tr>
</tbody>
</table>

Example (2). On March 1, 1913, the R Corporation sold the X Corporation stock in respect of which the distribution was made at $2,200, the adjusted basis for computing gain in computing net income, (§ 29.115-3), was $2,250. The difference of $7,000, which is equal to the amount by which the percentage depletion for the year 1932 (§ 29.115-3) exceeded the cost of the lease on March 1, 1913, and by reason of taking percentage depletion (§ 115 (1)) prescribed in section 112, is allocable between the old stock and the new stock in the ratio of $800 to $1,000. For the purpose of computing net income, the R Corporation has realized a gain of only $7,000 as a result of this transaction, all of which is deferred under section 115 (12) (c) for purposes of determining earnings and profits, however, will be $7,000 (though only $7,250 for the purpose of computing net income), computed as follows:

<table>
<thead>
<tr>
<th>Basis of property transferred</th>
<th>$7,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less money received on exchange</td>
<td>$7,250</td>
</tr>
<tr>
<td>Plus gain or loss recognized on exchange</td>
<td>None</td>
</tr>
</tbody>
</table>

Example (3). The B Corporation in exchange for 200 shares of the stock of the Z Corporation results in the nonrecognition in the earnings and profits of the Y Corporation. Such distribution is a result of the transaction. For increase in value of property accrued before, but realized on or after, March 1, 1913, see § 29.115-11.
after, March 1, 1913. The effect of this paragraph may be illustrated by the following examples:

Example (1). The X Corporation acquired nondepreciable property on March 1, 1913, at a cost of $10,000. Its fair market value as of March 1, 1913, was $12,000 and it was sold in 1942 for $11,400. The increase in earnings and profits accruing to the government of any foreign country or countries during the entire taxable year, amounts received from sources within the United States, amounts received from sources within foreign countries for a period of at least two years before the date on which he changes his domicile, any additions to income tax paid to the United States, any additions to income tax paid to any foreign country or countries, and any additions to income tax paid to the United States by a nonresident of the United States for more than six months during the taxable year, and there would be an increase in earnings and profits of the X Corporation consisting of the increase in value of property accrued before, but realized on or after, March 1, 1913.

Example (2). The Y Corporation acquired depreciable property in 1908 at a cost of $100,000. Assuming no additions or betterments, and that the depreciation was adjusted for the period subsequent to February 28, 1913, computed on such a cost basis that the depreciation deduction allowed (not less than the amount allowable after February 28, 1913, to the date of the sale in 1942) is $9,246. If the depreciation was computed on the adjusted cost of $100,000 ($100,000 less $2,000) $9,246 would be the amount applied in reduction of the decrease, namely, $9,000. The amount applied in reduction of the decrease, namely, $9,000, exceeds $8,000. Accordingly, as a result of the sale the excess of $900 of earnings and profits of the Y Corporation consisting of increase in value of property accrued before, but realized on or after, March 1, 1913, of which $760 ($11,400 less $10,640) is an increase in earnings and profits, and there would be a loss of $1,740. The application of the excess of earnings and profits of the Y Corporation consisting of increase in value of property accrued before, but realized on or after, March 1, 1913. If the amount so applied in reduction of the loss exceeds such loss, the excess over such loss shall increase that part of the earnings and profits consisting of increase in value of property accrued before, but realized on or after, March 1, 1913. The following examples will show the application of section 115 (m) (2):

Example (1). The Z Corporation acquired nondepreciable property prior to March 1, 1913, at a cost of $8,000. Its fair market value as of March 1, 1913, was $10,000, and it was sold in 1942 for $13,000. The increase in earnings and profits of the Z Corporation consisting of the increase in value of property accrued before, but realized on or after, March 1, 1913.

Example (2). The Y Corporation acquired depreciable property on March 1, 1913, at a cost of $10,000. Its fair market value as of March 1, 1913, was $12,000, and it was sold in 1942 for $11,400. The increase in earnings and profits of the Y Corporation consisting of the increase in value of property accrued before, but realized on or after, March 1, 1913.

Example (3). The Z Corporation acquired depreciable property on March 1, 1913, at a cost of $10,000. Its fair market value as of March 1, 1913, was $10,000, and it was sold in 1942 for $10,000. The increase in earnings and profits of the Z Corporation consisting of the increase in value of property accrued before, but realized on or after, March 1, 1913. If the amount so applied in reduction of the decrease, namely, $9,000, exceeds $8,000. Accordingly, as a result of the sale there would be a loss in earnings and profits of the Z Corporation consisting of increase in value of property accrued before, but realized on or after, March 1, 1913. The application of the excess of earnings and profits of the Y Corporation consisting of increase in value of property accrued before, but realized on or after, March 1, 1913. If the amount so applied in reduction of the loss exceeds such loss, the excess over such loss shall increase that part of the earnings and profits consisting of increase in value of property accrued before, but realized on or after, March 1, 1913.
of the tax as the amount which (but for the imposition of the tax imposed by this chapter) would be paid out of the use of such State, Territory, political subdivision, or the District of Columbia, bears to the amount of the net income from the operation of such public utility for such taxable year.

(2) If by the terms of such contract no part of the proceeds from the operation of such bridge shall be paid out of the use of such bridge, the tax upon the net income from the operation of such bridge shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this chapter.

(c) Bridges to be acquired by the political subdivision. Whenever any State or political subdivision thereof, in pursuance of a contract to which it is not a party entered into before May 29, 1928, is to acquire a bridge—

(1) If by the terms of such contract the tax imposed by this chapter is to be paid out of the proceeds from the operation of such bridge prior to any division of such proceeds, and if, but for the terms of such contract, a tax upon the net income from the operation of such bridge in the District of Columbia, then the tax upon the net income of such person from the operation of such bridge shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this chapter.

(2) Certificates by Secretary of State. The Secretary of State shall certify to the Secretary of the Treasury the names of the foreign countries which grant an equivalent exemption to the employees of the Government of the United States performing services in such foreign countries, and the character of the services performed by employees of the Government of the United States in such foreign countries.

§ 29.116–1 Earned income from sources without the United States. For taxable years beginning after December 31, 1942, there is excluded from gross income earned income in the case of an individual citizen of the United States who is a resident of a foreign country for at least two years prior to the date upon which he became a resident of the United States and ceased to be a resident of such foreign country or countries; (2) such amounts would constitute earned income.

§ 29.116–2 Income of foreign governments, ambassadors, and consuls. The exemption of the income of foreign governments applies also to their political subdivisions. Any income collected by foreign governments from investments in the United States but not actually owned by but are loaned to such foreign governments, is subject to tax.

All employees of a foreign government (including consular or non-diplomatic representatives) who are not citizens of the United States are exempt from Federal income tax with respect to wages, fees, or salaries received by them as compensation for official services rendered in the United States to such foreign government, provided (1) the services are of a character similar to those performed by citizens of the United States; (2) the foreign government's employees who are claiming exemption grants an equivalent exemption to the employees of the Government of the United States performing similar services in such foreign country; (3) such income does not represent amounts paid by the United States or any agency or instrumentality thereof. The application of this provision may be illustrated by the following example:

Example. A, a United States citizen making his return on a calendar year basis, has been a resident of X country for a period of four years ending December 31, 1942, at which time he was paid for such service and the United States is a bona fide resident of X country. By reason of the provisions of section 116 (a) (2) there shall not be allowed as a deduction from gross income any items of expenses or losses or other deductions properly applicable to or chargeable against the amounts so excluded from gross income.

In any case in which any amount otherwise constituting gross income is excluded from gross income under the provisions of section 116 (a), there shall not be allowed as a deduction from gross income any items of expenses or losses or other deductions properly applicable to or chargeable against the amounts so excluded from gross income.

For any taxable year beginning after December 31, 1941, in the case of an individual citizen of the United States, there shall be excluded from gross income earned income from sources without the United States derived during the period of his foreign residence if (1) such citizen was a bona fide resident of a foreign country or countries for at least two years prior to the date upon which he became a resident of the United States and ceased to be a resident of such foreign country or countries; (2) such amounts would constitute earned income.

§ 29.116–5 Dividend from "China Trade Act" corporation. In the case of a person, amounts distributed as dividends to or for his benefit during the period of four years ending June 30, 1930, are to be treated as dividend from a foreign corporation.

(1) If the services are of a character similar to those performed by employees of the Government of the United States in foreign countries or in the Commonwealth of the Philippines, the case may be, and if such services are performed in foreign countries which grant an equivalent exemption to the employees of the Government of the United States in such foreign countries the Secretary of State shall certify to the Secretary of the Treasury the names of such foreign countries, and the character of the services performed by employees of the Government of the United States in such foreign countries.
A showing which will establish to the satisfaction of the Commissioner that the State assumes the entire amount of the refund on behalf of the State or political subdivision which he assumes to represent and shall apply without delay the entire amount of refund in part or in full payment for the acquisition of such bridge, including copies of the laws, ordinances, or similar enactments constituting the basis of the claimant to establish its authority to receive the refund and so to apply it, together with a statement that such fiscal officer will receive and immediately so apply the entire amount of the refund; and

(4) An affidavit made by or on behalf of the taxpayer, which affidavit shall state that the taxpayer thereby joins with and concurs in the request of the Secretary of the Treasury under the provisions of this section, compensation thereof that a refund of an amount equal to all or a portion of the tax previously paid by such taxpayer be made to such State or political subdivision, and that for the amount refunded from the State or political subdivision to which it is paid and immediately to apply the entire amount of such refund in part payment for the acquisition of such bridge, and that if for any reason the contract which is the basis of the claim for refund is not fully executed and performed, the taxpayer will repay to the United States the entire amount of such refund in the manner and at the rate prescribed for the purpose of this section, to receive the same, and thereupon immediately to apply it, together with a statement that any fiscal officer will receive and immediately so apply the entire amount of such refund in part payment for the acquisition of such bridge, including copies of the laws, ordinances, or similar enactments constituting the basis of the claimant to establish its authority to receive the refund and so to apply it, together with a statement that such fiscal officer will receive and immediately so apply the entire amount of the refund, and shall file a claim therefor.

§ 29.116-3 Bridges to be acquired by State or political subdivisions. (a) Any State or political subdivision thereof claiming a refund under the provisions of section 116 (c) or (d) or (e) as to all or a portion of any income tax levied, assessed, collected, and paid by any agency or instrumentality thereof or by any political subdivisions or territories or possessions of the United States is exempt from Federal income tax. Similarly, under the provisions of the tax convention between the United States and Canada (effective January 1, 1941), wages, salaries, and similar compensation paid by Sweden or by any political subdivision or territory or possession thereof to individuals (other than citizens of the United States) residing in the United States are also exempt from Federal income tax. Similarly, under the tax convention between the United States and Canada (effective January 1, 1941), wages, salaries, and similar compensation paid by Canada or by any agency or instrumentality thereof or by any of the political subdivisions or territories or possessions of Canada to citizens of Canada residing in the United States are also exempt from Federal income tax.

(b) No refund shall be made of any amount in excess of the amount of the tax levied, assessed, collected, and paid by the taxpayer other than the income tax for the taxable year or period. A separate claim shall be made in respect of each separate taxable year or period. If by the terms of the contract on which the claim is based two or more States or more than one political subdivision thereof to all or a portion of any income tax levied, assessed, collected, and paid in the manner and at the rates prescribed in chapter 1, shall file a claim therefor on Form 943 (to which there shall be attached as exhibits the matter hereinafter prescribed) with the collector of internal revenue for the district in which the tax was paid, which claim shall be executed on behalf of such State or political subdivision thereof by the treasurer or other fiscal officer thereof and shall contain:

(1) A statement of the amount of the tax levied, assessed, collected, and paid for the taxable year or period in respect of which the claim is made, and the amount of refund thereby sought;

(2) A statement of the facts considered by the claimant sufficient to entitle it to receive the refund, including copies of all contracts and other documents bearing on the case, and a statement that the claim is submitted under the provisions of section 116 (c);

(3) A Definition. As used in this chapter—"capital gains" means property held by the taxpayer (whether or not connected with his trade or business, but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year). The term "capital gains" does not include property of a kind which the taxpayer primarily sells for customers in the ordinary course of his trade or business, or property used by the taxpayer in earning revenue, of a character which is subject to the allowance for depreciation provided in section 29.116 (e), (f), or (g) of the laws of the United States or of any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1931, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer;

(2) Short-term capital gains. The term "short-term capital gains" means gains from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent such gain is taken into account in computing net income;

(3) Long-term capital gains. The term "long-term capital gains" means gains from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;

(4) Net capital gains. The term "net capital gains" means gains from the sale or exchange of a capital asset held for one taxable year or portion thereof that a refund of an amount equal to all or a portion of the tax previously paid by such taxpayer be made to such State or political subdivision, and that for the amount refunded from the State or political subdivision to which it is paid and immediately to apply the entire amount of such refund in part payment for the acquisition of such bridge, and that if for any reason the contract which is the basis of the claim for refund is not fully executed and performed, the taxpayer will repay to the United States the entire amount of such refund in the manner and at the rate prescribed for the purpose of this section, to receive the same, and thereupon immediately to apply it, together with a statement that any fiscal officer will receive and immediately so apply the entire amount of such refund in part payment for the acquisition of such bridge, including copies of the laws, ordinances, or similar enactments constituting the basis of the claimant to establish its authority to receive the refund and so to apply it, together with a statement that such fiscal officer will receive and immediately so apply the entire amount of the refund; and

(4) A check or voucher in payment of a claim for refund allowed under section 116 (e) shall be executed on behalf of each State or political subdivision thereof by the treasurer or other fiscal officer thereof and shall contain:

(a) The name of the State of the taxpayer, the amount of tax levied, assessed, collected, and paid for the taxable year or period in respect of which the claim is made, and the amount of refund thereby sought;

(b) A statement of the facts considered by the claimant sufficient to entitle it to receive the refund, including copies of all contracts and other documents bearing on the case, and a statement that the claim is submitted under the provisions of section 116 (c);

(c) A check or voucher in payment of a claim for refund allowed under section 116 (e) shall be executed on behalf of each State or political subdivision thereof by the treasurer or other fiscal officer thereof and shall contain:

1) A statement of the amount of the tax levied, assessed, collected, and paid for the taxable year or period in respect of which the claim is made, and the amount of refund thereby sought;

2) A statement of the facts considered by the claimant sufficient to entitle it to receive the refund, including copies of all contracts and other documents bearing on the case, and a statement that the claim is submitted under the provisions of section 116 (c);
of such sales or exchanges, plus the net income
be allowed only to the extent of gains from
such excess, at the rates and in the manner
as if this subsection had not been enacted.
In computing net capital gain, net capital
loss, and net income:
60 per cent if the capital asset has been
held for not more than 6 months;
50 per cent if the capital asset has been
held for more than 6 months.
(c) Alternative Rates—(1) Corporations.
If for any taxable year the net long-term
capital gain of any corporation exceeds the
net short-term capital loss, the corporation
shall be levied, collected, and paid, in lieu of the
tax imposed by sections 13, 14, 15, 204, 207 (a) (1)
(G), and 609, a tax determined as follows, if
and only if such tax is less than the tax
Imposed by such sections:
A partial tax shall first be computed upon the
net income reduced by the amount of
such excess, at the rates and in the manner
as if this subsection had not been enacted,
and the total tax shall be the partial tax
plus 25 per centum of such excess.
(2) Other taxpayers. If for any taxable year
the net long-term capital gain of any taxpayer (other than a corporation)
and the net short-term capital loss, there shall be
levied, collected, and paid, in lieu of the
tax imposed by such sections 13, 14, 15, 204, 207 (a) (1)
(G), and 609, a tax determined as follows, if
and only if such tax is less than the tax
Imposed by such sections:
A partial tax shall first be computed upon the
net income reduced by the amount of
such excess, at the rates and in the manner
as if this subsection had not been enacted,
and the total tax shall be the partial tax
plus 60 per centum of such excess.
(d) Limitations—(1) Corporations. In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from
such sales or exchanges.
(2) Other taxpayers. In the case of a taxpayer,
other than a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from
such sales or exchanges plus the net income
of the taxpayer for 12,000, whichever is
smaller. For purposes of this paragraph, net
income shall be computed without regard to
losses from sales or exchanges of capital assets.
(e) Capital loss carry-over.—(1) Method of
computation. If a taxpayer, other than a corporation,
during any taxable year, whether following December 31, 1941, the taxpayer has a net capital loss, the amount thereof shall be a short-term capital loss in each of the five succeeding taxable years to the ex-
tent that such amount exceeds the total of
any net capital gains of any taxable years
Intervening between the taxable year in which
the net capital loss areas and such succeeding
year. For purposes of this paragraph a net capital gain shall be computed without regard to such net capital loss or
to any net capital losses arising in any such
Intervening taxable year.
(2) Rule for determination of capital loss carry-over from 1941. The amount of the net short-term capital loss of the last taxable
year beginning or ending before December 31, 1941, which is not in excess of the net in-
come for such taxable year, shall, to the extent of the net short-term capital gain for
the succeeding taxable year (computed without regard to computations relating to short-term capital losses), be a short-term capital loss of such succeeding taxable year.
(f) Retirement of bonds, etc. For the pur-
pouses of this chapter, amounts received by
the holder upon the retirement of bonds, debentures, notes, certificates or other

testimony of indebtedness issued by any corpor-
ations (including those issued by a gov-
ernment or political subdivision thereof),
with interest coupons or in registered form,
shall be considered as amounts received in
exchange therefor.
(g) Gains and losses from short sales, etc. For
the purpose of this chapter, a short sale
of property shall be considered as gains or losses from
sales or exchanges of capital assets;
and
(2) gains or losses attributable to the failure
to exercise, privileges or options to buy
such property which should be considered as short-
term capital gains or losses.
(h) Determination of period for which held.
For the purpose of this section—
(1) In determining, (g), for which the taxpayer has held property received on an
exchange there shall be included the period
for which such property was held by any
other person in the case of transactions of sec-
tion 115, such property has, for the purpose of
determining gain or loss from a sale or
exchange, the same basis in whole or in part
in his hands as it would have in the hands of
such other person.
(2) In determining the period for which the taxpayer has held stock or securities
received upon a distribution, the same basis in whole or in part in his
hands as the property exchanged. For the purposes of this paragraph, an involuntary
conversion of any character (including a
requisition or condemnation or the threat or
involuntary conversion of any character)
may be included in the inventory of the
taxpayer if on the hand at the close of the
taxable year, the taxpayer has hold stock
received upon a distribution, or the tax-
player primarily for sale to customers in the
ordinary course of his trade or business.
(3) General rule. If, during any taxable
year, the recognized gains and losses from
sales or exchanges of property used in the trade or
business, plus the recognized gains from the
compensation of a taxpayer (other than a
corporation) shall exceed the total of
the gains and losses described therein shall
be included only to the extent taken into account
in computing net short-term capital losses;
and if such gains do not exceed such losses, such gains
and losses shall be considered as gains and
losses from sales or exchanges of capital assets.
For the purposes of this paragraph:
(A) In determining whether losses exceed gains, the gains and
losses described therein shall be included only
if and to the extent taken into account in
computing net short-term capital losses;
and
(B) Losses upon the destruction, in whole or in part, by
fire, theft, or by acts of God, or by
condemnation of property used in the trade or
business for the purpose of such losses,
shall be considered as gains and losses
from involuntary conversion of such
property.
§ 29.1171—Meaning of terms. The term “capital assets” includes all classes of
property not specifically excluded by
section 117 (a) (1). In determining whether property is a “capital asset,” the
period for which held is immaterial.
The exclusion from the term “capital assets” of property used in the trade or
business of a taxpayer, which is subject to the allowance for depreciation
provided in section 23 (1) and of real property used in the trade or
business of a taxpayer is limited to such
property used by the taxpayer in the
trade or business of a taxpayer by
exclusion, exchange, or involuntary
conversion. Gains and losses from such
property are not subject to the percentage provisions of section 117 (b) and
losses from such transactions are not subject to the percentage provisions of section 117 (d), except
that under section 117 (j) the gains and
losses from the sale or exchange of such property held for more than six months may be treated as gains and losses from the sale or exchange of capital assets, and may thus be subject to such limitations. See § 29.117–7. Property held for the production of income, but not used in a trade or business of the taxpayer, is not subject to the term "capital assets" even though depreciation may have been allowed with respect to such property under section 23 (I) prior to its amendment by the Revenue Act of 1942. However, upon the exchange of land held by a taxpayer primarily for sale to customers in the ordinary course of his business, as in the case of a dealer in real estate, is not subject to any such obligations.

Obligations of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued after May 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, are excluded from the term "capital assets." An obligation (see § 29.117–2) that may be issued on a discount basis even though the price paid exceeds the face amount. Thus, although the Second Liberty Bond Act provides that United States Treasury bills shall be issued on a discount basis, the issuing price paid for a particular bill may, by reason of competitive bidding, actually exceed the face amount of the bill. Since the effects of the above described in this paragraph are excluded from the term "capital assets," gains or losses from the sale or exchange of such obligations are not subject to the percentage provisions of section 117 (b) and losses from such transactions are not subject to the limitation on losses provided in section 117 (d). It is, therefore, not necessary for a taxpayer, other than a life insurance company, to segregate gains and losses from sales or exchanges of capital assets over the sum allowed under section 117 (e) short-term capital losses for such taxable year.

Gains and losses from the sale or exchange of capital assets held for not more than one year (described as "short-term capital gains and short-term capital losses") shall be segregated from gains and losses arising from the sale or exchange of such assets held for more than one year (described as "long-term capital gains and long-term capital losses"). The percentage brackets of section 117 (b) have no application to corporations, corporate gains and losses sales of the corporation are subject to taxation only on interest, dividends, and rents, to segregate the original discount accrued (see § 29.62–7) and the gain or loss realized upon the sale or other disposition of gains from such sales or exchanges.

Example (1). A (not a life insurance company) buys a $100,000 90-day Treasury bill upon issuance for $99,999.50. As of the close of the forty-fifth day of the life of such bill, he sells it to B (not a life insurance company) for $99,999.50. The entire net gain to A of $50.50 may be taken into account as a single item of income, without allocating it to interest and $0.50 to gain. If $B holds the bill until maturity his net gain of $50.50 may similarly be taken into account as a single item of income, without allocating $1 to interest and $0.50 to gain.

Example (2). In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed as deductions only to the extent of the gains from such sales or exchanges, and section 117 (d) (2) prevents the application of the term "net capital gain" means the excess of (1) the sum of the gains from sales or exchanges of capital assets, plus net income (computed without regard to gains and losses from sales or exchanges of capital assets) of the taxpayer or $1,000, whichever is smaller, over (2) the losses from such sales or exchanges, which losses include any amounts brought forward pursuant to section 117 (e). In the case of a taxpayer other than a corporation the term "net capital gain" means the excess of (1) the sum of the gains from sales or exchanges of capital assets, plus net income (computed without regard to gains and losses from sales or exchanges of capital assets) of the taxpayer or $1,000, whichever is smaller, over (2) the losses from such sales or exchanges, which losses include any amounts brought forward pursuant to section 117 (e). For application of the term "net capital gain" in computing the capital loss carry-over under section 117 (d), see § 29.117–2 (c).

Section 117 (a) (11) defines "net capital loss" to mean the excess of the losses from sales or exchanges of capital assets over the sum allowed under section 117 (d). However, amounts which are short-term capital losses under section 117 (e) (1) are excluded in determining such "net capital loss."
The net capital loss is $50,000. This figure, computed in accordance with section 117 (b), is the excess of the losses from sales or exchange of capital assets over the sum of (1) gains from such sales or exchanges, and (2) net income of $500. This amount may be carried forward to 1945. However, in 1945 there was a net capital gain of $35,000, as defined by section 117 (a) (10) (2) and limited by section 117 (e) (1), against which this net capital loss of $50,000 is allowed in part. The remaining portion—$29,500—may be carried forward to 1946 and 1945 since there was no net capital gain in 1944. In 1946 this $29,500 shall be allowed in full against net capital gain of $36,000, as defined by section 117 (a) (10) (3) and limited by section 117 (e) (1).

Section 29.117-3  Alternative tax in case of net long-term capital gain or loss. In case the net long-term capital gain of a taxpayer (other than a corporation) exceeds the net short-term capital loss, section 117 (c) (2) imposes an alternative tax in lieu of the tax imposed by sections 111 and 12. If and only if such alternative tax is less than the tax otherwise imposed, the correct tax is the alternative tax, that is, $79,126. The tax is computed as follows:

**TAX UNDER SECTIONS 111 AND 12**

<table>
<thead>
<tr>
<th>Ordinary net income</th>
<th>$160,000.00</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net long-term capital gain</td>
<td>(50 per cent of $100,000)</td>
</tr>
<tr>
<td>Net short-term capital loss</td>
<td>(10 per cent of $20,000)</td>
</tr>
</tbody>
</table>

Excess of the net long-term capital gain over the net short-term capital loss $50,000.00

Total net income 190,000.00

Less Credit for personal exemption 1,200.00

Surtax net income 128,800.00

Less earned income credit (10 percent of $3,000) 300.00

Income subject to normal tax 128,500.00

Normal tax (6 percent of $78,000) 4,710.00

Surtax on $128,500 81,892.00

Total tax 96,602.00

**Alternative Tax Under Section 117 (c) (2).**

Net income $150,000.00

Less Excess of the net long-term capital gain over the net short-term capital loss 20,000.00

Ordinary net income 130,000.00

Less Credit for personal exemption 1,200.00

Surtax net income $98,800.00

Less earned income credit (10 percent of $3,000) 300.00

Income subject to normal tax $98,500.00

Normal tax (6 percent of $60,000) 3,600.00

Surtax on $98,500 56,210.00

Partial tax under sections 111 and 12 on $100,000 64,120.00

Plus 50 percent of $30,000 15,000.00

Total alternative tax $79,126.00

**§ 29.117-4 Determination of period for which capital assets are held.** Under section 117 (b) if property is acquired in certain transactions described in sections 113, 115, 118, and 371 (e), the period for which such property is considered to have been held by the taxpayer is not computed from the date such property was acquired by the taxpayer but from a prior date. For instance: In the case of stock or securities in a corporation a party to a reorganization received pursuant to a plan of reorganization in exchange solely for stock in another corporation a party to the reorganization, the period for which the stock or securities exchanged were held by the taxpayer must be included in the period for which the stock or securities received on the exchange were held by the taxpayer. In the case of property acquired after December 31, 1920, by a corporation other than a corporation subject to the provisions of section 113, such property has, for the purposes of determining gain or loss from the sale or exchange, the same basis in the hands of the taxpayer as it would have had in the hands of the donor, the period for which the property was held by the donor must be included in the period for which the property was held by the taxpayer. In the case of stock or securities the acquisition of which resulted in the nondeductibility (under section 118 of the Internal Revenue Code or under section 118 of the Revenue Act of 1926, 1928, 1932, 1934, 1936, or 1938) of the loss from the sale or other disposition of bonds, debentures, notes or certificates, or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof) with interest coupons or in registered form, over gains of the taxable year from such sales or exchanges may be deductible as an ordinary loss for the taxable year which can be carried forward to the next five succeeding taxable years. The practical operation of the provisions of section 117 (c) (1) may be illustrated by the following example:

Example. For the taxable years 1942 to 1946, inclusive, a taxpayer is assumed to have a net short-term capital loss, net short-term capital gain, net long-term capital loss, net long-term capital gain, and net income as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Short-term Loss</th>
<th>Net Long-term Gain</th>
<th>Net Capital Loss</th>
<th>Net Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1942</td>
<td>$(50,000)</td>
<td>$(20,000)</td>
<td>$(29,500)</td>
<td>$(10,000)</td>
</tr>
<tr>
<td>1943</td>
<td>$(40,000)</td>
<td>$(10,000)</td>
<td>$(39,000)</td>
<td>$(14,000)</td>
</tr>
<tr>
<td>1944</td>
<td>$(25,000)</td>
<td>$(5,000)</td>
<td>$(30,000)</td>
<td>$(25,000)</td>
</tr>
<tr>
<td>1945</td>
<td>$(10,000)</td>
<td>$(5,000)</td>
<td>$(15,000)</td>
<td>$(30,000)</td>
</tr>
</tbody>
</table>

The net capital loss is $19,500. This figure, computed in accordance with section 117 (b), is the excess of the losses from sales or exchange of capital assets over the sum of (1) gains from such sales or exchanges and (2) net income of $600. This amount may be carried forward to 1946. However, in 1945 there was a net capital gain of $25,000, as defined by section 117 (a) (10) (3) and limited by section 117 (e) (1), against which this net capital loss of $19,500 is allowed in part. The remaining portion—$4,500—may be carried forward to 1946 and 1945 since there was no net capital gain in 1944. In 1946 this $4,500 shall be allowed in full against net capital gain of $35,000, as defined by section 117 (a) (10) (4) and limited by section 117 (e) (1).
substantially identical stock or securities, the period for which the stock or securities were held for the sale or other disposition of which was not deductible, shall be included in the period for which the stock or securities acquired were held by the taxpayer. If property acquired as the result of a compulsory or involuntary conversion of other property of the taxpayer, the period for which the property so converted, the period for which the stock or securities acquired by the taxpayer must be included in the period for which the property acquired was held by the taxpayer.

The period for which the taxpayer has held stock, or stock subscription rights, issued to him as a dividend shall be determined as though the stock dividend, or stock right, as the case may be, were the stock in respect of which the dividend was issued if the basis for determining gain or loss upon the sale or other disposition of such stock dividend or stock right is fixed by the apportionment of the basis of such old stock.

If the taxpayer has held stock or securities issued to him by a corporation pursuant to the exercise of rights, to acquire such stock or stock right, as the case may be, were the stock in respect of which the dividend was issued if the basis for determining gain or loss upon the sale or other disposition of such stock dividend or stock right is fixed by the apportionment of the basis of such old stock.

A joint return for the taxable year of a husband and wife making a joint return, the limitation under section 117 (d) (2), relating to the allowance of losses from sales or exchanges of capital assets, is to be computed and the net capital loss determined with respect to the combined capital gains and losses of the spouses.

If a husband and wife making a joint return for any taxable year beginning after December 31, 1941, did not make a joint return for the preceding taxable years (not exceeding five taxable years and beginning after December 31, 1941), the individual net capital loss of each spouse for the taxable years (not exceeding five taxable years and beginning after December 31, 1941), a net capital loss as shown by each joint return shall be a short-term capital loss for the taxable year to the extent provided by section 117 (e) (1). If, however, a joint return was made for each of the taxable years beginning after December 31, 1941, and the aggregate net capital loss for the taxable years beginning after December 31, 1941, a net capital loss as shown by each such joint return shall be allocated to the spouses on the basis of their individual net capital losses for such taxable years for the purposes of section 117 (g).

The alternative taxes computed under section 117 (c) (2) are in lieu of taxes imposed by sections 11 and 12 and must be compared with the tax imposed by such sections to determine which tax is applicable. In computing the alternative taxes under section 117 (c) (2), in the case of a joint return, the determination of the net long-term capital gains and losses over short-term capital losses of the spouses, is to be made by combining the long-term capital gains and losses and the short-term capital gains and losses of the spouses for the taxable year. If the aggregate of such losses exceeds the aggregate of such gains, such gains and losses shall be treated as gains and losses from the sale or exchange of capital assets held for more than six months.

In determining whether such gains exceed such losses for the purposes of section 117 (j), losses upon the disposition in whole or in part of capital assets held for more than six months, shall be treated as gains and losses from the sale or exchange of capital assets held for more than six months, if the aggregate of such losses exceeds the aggregate of such gains. If the aggregate of such gains does not exceed the aggregate of such losses, such gains and losses shall not be treated as gains and losses from the sale or exchange of capital assets.

§ 29.117-6 Gains and losses from short sales. For income tax purposes, a short sale is not deemed to be consummated until delivery of property to cover the short sale, and the percentage of the recognized gain or loss to be taken into account under section 117 (b) from a short sale shall be computed according to the period for which the property so delivered was held. Thus, if a taxpayer made a short sale of shares of stock and covered the short sale by purchasing and delivering shares which he held for not more than six months, 100 percent of the recognized gain or loss would be taken into account under section 117 (b), even though he had held other shares of the same stock which he held for more than six months. If the short sale is made through a broker and the broker borrows property to make delivery, the short sale is not deemed to be consummated until the obligation of the seller created by the short sale is finally discharged by delivery of property to the broker. The property borrowed by the broker.

§ 29.117-7 Gains and losses from involuntary conversions and from the sale or exchange of certain property used in the trade or business. Section 117 (j) provides that the recognized gains and losses:

(a) From the sale, exchange, or involuntary conversion of property used in the trade or business of the taxpayer at the time of the sale, exchange, or involuntary conversion, held for more than six months, which is:

(1) Of a character subject to the allowance for depreciation provided in section 23 (1), or
(2) Real property, and
(b) From the involuntary conversion of capital assets held for more than six months shall be treated as gains and losses from the sale or exchange of capital assets held for more than six months, if the aggregate of such gains exceeds the aggregate of such losses. If the aggregate of such gains does not exceed the aggregate of such losses, such gains and losses shall not be treated as gains and losses from the sale or exchange of capital assets.

In determining whether such gains exceed such losses for the purposes of section 117 (j), losses upon the disposition in whole or in part of capital assets held for more than six months, shall be treated as gains and losses from the sale or exchange of capital assets held for more than six months, if the aggregate of such losses exceeds the aggregate of such gains. If the aggregate of such gains does not exceed the aggregate of such losses, such gains and losses shall not be treated as gains and losses from the sale or exchange of capital assets.
With these exceptions as to sections 117 (b) and 117 (d), gains and losses are included in the computations under section 117 (j) only to the extent that they are taken into account in computing net income. Thus, losses which are not deductible items under section 24 or section 118 are not included in the computations under section 117 (j). Similarly, if a taxpayer reports on the installment basis under section 44 the gain on the sale of property described in section 117 (j), such losses are then not subject to the percentage limitations in section 117 (b), (c), and (d), relating to the percentage taken into account, the alternative tax in the case of capital gains and losses, and the extent to which capital gains are allowed. If it is determined under the above computations that the gains do not exceed the losses, none of such gains and losses are treated as gains and losses from the sale or exchange of capital assets held for more than six months, and a gain of $400 on the sale, exchange, or other disposition of shares of stock or securities where it appears that, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date, the taxpayer has acquired (by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law), or has entered into a contract or option to acquire, substantially identical shares of stock or securities, the loss shall be allowed under section 118 (e) (3); nor shall such deduction be allowed under section 29 (3) unless the claim is made by a corporation, a dealer in stocks or securities, and with respect to a transaction made in the ordinary course of its business.

Since the aggregate of the recognized gains ($12,600) exceeds the aggregate of such gains and losses are treated under section 117 (b) as gains and losses from the sale or exchange of capital assets held for more than six months, the losses are then subject to the percentage limitations provided in section 117 (d).

Example (2). A's recognized gains and losses for 1942 of the kind described in section 117 (j), computed without regard to the limitations in section 117 (b), are as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Gains</th>
<th>Losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gain from sale of property</td>
<td>$12,600</td>
<td></td>
</tr>
<tr>
<td>Loss from sale of property</td>
<td></td>
<td>$12,600</td>
</tr>
</tbody>
</table>

The following examples will illustrate the operation of the provisions of section 117 (j):

Example (1). A, an individual, makes his return for 1940 on the calendar year basis. A's recognized gains and losses for 1940 of the kind described in section 117 (j), computed without regard to the percentage limitations in section 117 (b), are as follows:

1. Gain on sale of machinery, used in the business and subject to depreciation, held for more than six months... $4,000
2. Gain reported in (under section 44) in installment sale in 1941 of property Premier used in the business (including building and land, each held for more than six months)... $8,000
3. Gain reported in 1942 (under section 44) on installment sale in 1943 of property Premier used in the business (including building and land held for more than six months, used in the business as storage lot for trucks... $2,000
4. Gain on proceeds from requisition by Government of boat, held for more than six months, used in the business and subject to depreciation... $500
5. Loss upon the destruction by fire of warehouse used for more than six months and used in the business (excess of adjusted market value of warehouse over compensation by insurance, etc.)... $3,000
6. Loss upon theft of uninsured better bonds, held for more than six months... $5,000
7. Loss in storm of pleasure yacht, purchased in 1940 for $1,800 and having a fair market value of $9,000 at the time of the storm... $1,000
8. Total gains... 12,600
9. Total losses... 9,000
10. Excess of gains over losses... 3,500

Since the aggregate of the respective recognized gains ($12,600) exceeds the aggregate of such gains and losses are treated under section 117 (j) as gains and losses from the sale or exchange of capital assets held for more than six months, the losses are then subject to the percentage limitations provided in section 117 (b). A will take into account only 50 percent of the amount of items 1 and 2 (taxable gains) and 100 percent of items 3 to 7, which are treated as any other long-term gains and losses of A, and will cause the inclusion of $1,750 (25 percent of item 10) in computing his net long-term capital gain for the purposes of the alternative tax provided by section 117 (c) (2).

Example (2). A's yacht, used for pleasure and acquired for such use in 1938 at a cost of $25,000, was requisitioned by the Government in 1942 for $15,000. A sustained no deductible loss, and no loss with respect to such requisition will be included in the computations under section 117 (j) (2).

Example (3). If in example (1) the taxpayer were a corporation, then there would be taken into account 100 percent of the gains and losses in items 1 to 7, which are treated for all purposes as gains and losses from the sale or exchange of capital assets held for more than six months. The percentage provisions of section 117 (b) do not apply to corporations. These items will cause the inclusion of $3,500 (item 10) in computing the net long-term capital gain of the corporation for the purposes of the alternative tax provided by section 117 (c) (1).

Example (4). If in example (1) A also had a loss of $4,000 from the sale under threat of condemnation of a capital asset held for more than six months, such losses exceed such gains, and such losses are not subject to the percentage limitations in section 117 (b), (c), and (d). If A, therefore, in addition to the loss of $4,000, had a gain of $4,000 from the sale of a capital asset held for less than six months, such losses exceed such gain, and such gains are not subject to the percentage limitations in section 117 (b), (c), and (d). Similarly, if a taxpayer reports on the installment basis under section 44 the gain on the sale of property described in section 117 (j), such losses are then not subject to the percentage limitations in section 117 (b), (c), and (d), relating to the percentage taken into account, the alternative tax in the case of capital gains and losses, and the extent to which capital gains are allowed. If it is determined under the above computations that the gains do not exceed the losses, none of such gains and losses are treated as gains and losses from the sale or exchange of capital assets held for more than six months, and a gain of $400 on the sale, exchange, or other disposition of shares of stock or securities where it appears that, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date, the taxpayer has acquired (by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law), or has entered into a contract or option to acquire, substantially identical shares of stock or securities, the loss shall be allowed under section 118 (e) (3); nor shall such deduction be allowed under section 29 (3) unless the claim is made by a corporation, a dealer in stocks or securities, and with respect to a transaction made in the ordinary course of its business.

(b) If the amount of stocks or securities acquired (or covered by the contract or option to acquire) is not less than the amount of stock or securities sold or otherwise disposed of, then the particular shares of stock or securities the loss from the sale or other disposition of which is not deductible shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

§ 29.118-1 Losses from wash sales of stock or securities. (a) A taxpayer cannot deduct any loss claimed to have been sustained from the sale or other disposition of stock or securities, if, within a period of 30 days before the date of such sale or disposition and ending 30 days after such date (referred to in this section as the 61-day period), he has acquired (by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law), or has entered into a contract or option so to acquire, substantially identical shares of stock or securities, the acquisition of which (or the contract or option to acquire) would result in the nondeductibility of the loss shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary.
The identity of the lots cannot be determined and § 29.22 (a) (10) - 1 for the basis for determining gain or loss from the subsequent sale or other disposition of stock or securities acquired in connection with wash sales.

Due to the 60-day period to claim a loss, if the loss is claimed to have been sustained within the taxable year from the sale or other disposition of stock or securities, the provisions of this section shall be applied to the losses in the order in which the taxable year from the sale or other disposition of stock or securities sold or otherwise disposed of at different dates or at different prices which the identity of the lots cannot be determined and § 29.22 (a) (10) - 1 for the basis for determining gain or loss from the subsequent sale or other disposition of stock or securities acquired in connection with wash sales.

Due to the 60-day period to claim a loss, if the loss is claimed to have been sustained within the taxable year from the sale or other disposition of stock or securities sold or otherwise disposed of at different dates or at different prices which the identity of the lots cannot be determined and § 29.22 (a) (10) - 1 for the basis for determining gain or loss from the subsequent sale or other disposition of stock or securities acquired in connection with wash sales.

The amount of stock or securities acquired within the 61-day period to claim a loss, if the loss is claimed to have been sustained within the taxable year from the sale or other disposition of stock or securities sold or otherwise disposed of at different dates or at different prices which the identity of the lots cannot be determined and § 29.22 (a) (10) - 1 for the basis for determining gain or loss from the subsequent sale or other disposition of stock or securities acquired in connection with wash sales.

The amount of stock or securities acquired within the 61-day period to claim a loss, if the loss is claimed to have been sustained within the taxable year from the sale or other disposition of stock or securities sold or otherwise disposed of at different dates or at different prices which the identity of the lots cannot be determined and § 29.22 (a) (10) - 1 for the basis for determining gain or loss from the subsequent sale or other disposition of stock or securities acquired in connection with wash sales.

The amount of stock or securities acquired within the 61-day period to claim a loss, if the loss is claimed to have been sustained within the taxable year from the sale or other disposition of stock or securities sold or otherwise disposed of at different dates or at different prices which the identity of the lots cannot be determined and § 29.22 (a) (10) - 1 for the basis for determining gain or loss from the subsequent sale or other disposition of stock or securities acquired in connection with wash sales.

The amount of stock or securities acquired within the 61-day period to claim a loss, if the loss is claimed to have been sustained within the taxable year from the sale or other disposition of stock or securities sold or otherwise disposed of at different dates or at different prices which the identity of the lots cannot be determined and § 29.22 (a) (10) - 1 for the basis for determining gain or loss from the subsequent sale or other disposition of stock or securities acquired in connection with wash sales.
(1) Interest other than that derived from sources within the United States as provided in subsection (a) of this section;

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

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

(4) Rents derived from property located without the United States or from any interest in such property, including rentals or royalties for the use of, or the privilege of using without the United States, any copyright, patent, or any similar or related right.

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

(6) Net income from sources without United States. From the items of gross income specified in subsection (a) of this section there shall be deducted the expenses, losses, and other deductions properly apportioned or allocable thereto, and part of any expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income. The remainder is treated as derived partly from sources within and partly from sources without the United States.

Income from sources partly within and partly without United States. Items of gross income, expenses, losses, and deductions, other than those treated under paragraphs (a), (e) and (c) of this section, shall be allocated or apportioned to sources within or without the United States, under rules and regulations prescribed by the Commissioner with the approval of the Secretary. Where items of gross income are separately allocated to sources within or without the United States, the net income shall be treated as derived partly from sources within and partly from sources without the United States.

Income from sources wholly without United States. All other income which is derived partly from sources within or without the United States, shall be treated as derived partly from sources within and partly from sources without the United States.

$29.119-1 Income from sources within the United States. Nonresident alien individuals, foreign corporations, and other than a corporation, or a domestic corporation, is entitled to the benefits of section 251 are, however, taxable upon income received within the United States, whether derived from sources within or without the United States. (See sections 212 (a), 231 (c), and 251.)

The Internal Revenue Code divides the income of such taxpayers into three classes:

(a) Income which is derived in full from sources within the United States;

(b) Income which is derived in full from sources without the United States; and

(c) Income which is derived partly from sources within and partly from sources without the United States.

The taxable income from sources within the United States shall be the net income of such resident individual, foreign corporation, or domestic corporation, or a non-resident alien on a refund of Federal income taxes as income from sources within the United States.

As to the inclusion in gross income of items received in the manner of income which is derived partly from sources within the United States and that portion of the income which is derived partly from sources within the United States which is allocated or apportioned to sources within the United States.

§ 29.119-2 Interest. There shall be included in the gross income from sources within the United States, of non-resident individuals, foreign corporations, and domestic corporations which are entitled to the benefits of section 251, all interest received or accrued, as the case may be, from sources within the United States; but only in an amount necessary to show that the income is of the type specified in the paragraphs.

(a) From a domestic corporation other than that derived in full from sources within the United States, dividends from a foreign corporation or a foreign corporation or a domestic corporation, or a domestic corporation, which bears the same ratio to such dividends, or for such part of such period as the corporation has been in existence; or

(b) From a foreign corporation unless the 50 percent of its gross income for the 5-year period ending with the close of its taxable year preceding the declaration of such dividends, or for such part of such period as it has been in existence, was derived from sources within the United States; but only in an amount which bears the same ratio to such dividends as the gross income of the corporation for such period derived from sources within the United States to its gross income from all sources.

Dividends shall be treated as income from sources within the United States (except for the purposes of section 131) unless the taxpayer submits sufficient data to establish the satisfaction of the Commissioner that they should be excluded from gross income under par-
§ 29.119-4 Compensation for labor or personal services. Except as provided in section 119 (a) (3), gross income from sources within the United States includes compensation for labor or personal services performed within the United States regardless of the residence of the payor, of the place in which the contract for service was made, or of the place of payment. If a specific amount is paid for labor or personal services performed in the United States, such amount (if income from sources within the United States) shall be included in the gross income. If no accurate allocation or segregation of compensation for labor or personal services performed in the United States can be made, or when such labor or service is performed partly within and partly without the United States, the amount to be included in the gross income shall be determined by an apportionment. (In other words, i.e., there shall be included in the gross income an amount which bears the same relation to the total compensation as the number of days of performance of the labor or service bears to the total number of days of performance of labor or service for which the payment is made. Except as provided in section 119 (a) (3), wages, salaries, tips, fees, profits, and gains derived within the territorial limits of the United States and wages of an alien seaman earned on a coastwise vessel are to be regarded as from sources within the United States. § 29.119-8 Sale of personal property. Income derived from the purchase and sale of personal property shall be treated as derived entirely from the country in which sold, except that income derived from the sale of real property located in the United States and its sale within the United States shall be treated as derived partly from sources within and partly from sources without the United States. A possession of the United States constitutes a "country," within the meaning of this section, separate and distinct from the labor or service performed within its territorial limits. Hence income derived from the purchase and sale of personal property located within the United States and its sale within the United States shall be treated as derived entirely from a possession of the United States. The word "sold" includes "exchanged." The "country in which sold" ordinarily means the place where the property is marketed. This section does not apply to income from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States or produced (in whole or in part) by the taxpayer without the United States. See § 29.119-12.) § 29.119-10 Apportionment of deductions. From the items specified in §§ 29.119-1 to 29.119-9, inclusive, as being derived from sources within the United States there shall, in the case of nonresident alien individuals and foreign corporations engaged in trade or business within the United States, be deducted the expenses, losses, and other deductions properly apportioned or allocated, and a ratable part of any other expenses, losses, or deductions which cannot definitely be allocated to some item or class of gross income. The remainder shall be included in full as net income from sources within the United States. The ratable part is based upon the ratio of gross income from sources within the United States to the total gross income. Example. A nonresident alien individual engaged in trade or business within the United States whose taxable year for the calendar year derived gross incomes from all sources for 1942 of $8,000,000, including therein:

- Interest on bonds of a domestic corporation $ 2,000
- Dividends on stock of a domestic corporation 4,000
- Royalties for the use of patents within the United States 12,000
- Gain from sale of real property located within the United States 11,000

Total $36,000

that is, one-fifth of the total gross income was from sources within the United States. Furthermore, the remainder of the gross income was from sources without the United States, determined under § 29.119-7.

The expenses of the taxpayer for the year amounted to $78,000. Of these expenses the amount of $8,000 is properly allocated to income from sources within the United States and the amount of $46,000 is properly allocated to income from sources without the United States. The remainder of the expenses, $26,000, is the net income from sources within the United States. § 29.119-11 Other income from sources within the United States. Items of gross income other than those specified in section 119 (a) and (e) shall be allocated or apportioned to sources within or without the United States, as provided in section 119 (b). The income derived from the ownership or operation of any farm, mine, oil or gas well, other natural deposit, or timber, located within the United States, and the sale of the products thereof within or without the United States, shall ordinarily, be included in gross income from sources within the United States. If, however, it is shown to the satisfaction of the Commissioner that due to the peculiar conditions of production and sale in a specific case or for other reasons all of such income should not be allocated to sources within the United States, an apportionment thereof to sources within the United States and to sources without the United States shall be made as provided in §§ 29.119-12.

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

§ 29.119-12 Income from the sale of personal property derived from sources within the United States.
partly within and partly without the United States. Items of gross income not allocated by § 29.119-1 to 29.119-3, inclusive, or § 29.119-11, to sources within or without the United States, and within the foreign country, the portion attributable to sources within and partly within the United States shall be treated as derived from sources partly within the United States and partly within a possession of the United States.

(a) The portion of such income derived from sources partly within the United States and partly within a foreign country which is attributable to sources within the United States shall be determined according to the following rules and cases:

Personal property produced and sold. Gross income derived from the sale of personal property produced (in whole or in part) by the taxpayer within the United States shall be treated as derived from sources partly within the United States and partly within a foreign country, and (b) income derived from sources partly within the United States and partly within possession of the United States shall be treated as derived from sources partly within the United States and partly within a possession of the United States being determined according to the following rules and cases:

Case 1 A. Where the manufacturer or producer regularly sells part of his output to wholly independent distributors or other selling concerns in such a way as to establish fairly an independent factory or production price—or shows to the satisfaction of the Commissioner that such an independent factory or production price has been otherwise established —unaffected by considerations of tax liability, the selling or distributing branch or department of the business to the distributing or selling department at the independent factory price so established. In all cases the basis of the accounting shall be fully explained in a statement attached to the return.

Case 2 A. Where an independent factory or production price has not been established under Case 1 A, the net income shall first be computed by deducting from the gross income derived from the sale of personal property produced (in whole or in part) by the taxpayer within the United States and sold within a foreign country or produced (in whole or in part) by the taxpayer within a foreign country and sold within the United States shall be treated as derived from sources partly within the United States and partly within possession of the United States with a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. Of the amount of net income so determined, as at the beginning or end of the taxable year or period ordinarily may be used, unless by reason of material changes during the taxable year or period such average does not fairly represent the average for such year or period, in which event the average shall be determined upon a monthly or daily basis. Bills and accounts receivable shall (unless satisfactory reason for a different treatment is shown) be assigned or allocated to the United States when the debtor resides in the United States, unless the taxpayer has no office, branch, or agency within the United States.

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

Personal property produced and sold. Gross income derived from the sale of personal property produced (in whole or in part) by the taxpayer within the United States and sold within a possession of the United States shall be treated as derived partly from sources within the United States and partly within a foreign country, and

Case 2 B. Same as case 1 A.

Case 2 C. Where an independent factory or production price has not been established as provided under case 1 A, the net income derived from the sale of personal property produced (in whole or in part) by the taxpayer within the United States and sold within the United States shall be treated as derived partly from sources within the United States and partly within possession of the United States with a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated thereto and a ratable part of the income derived from the sale of personal property produced (in whole or in part) by the taxpayer within the United States and sold within a foreign country shall be treated as derived from sources partly within the United States.
nominator of which consists of the amount of the taxpayer's business for the taxable year or period both within the United States and within the possession of the United States. The "business of the taxpayer" as that term is used in this paragraph shall be measured by the amounts which the taxpayer paid out during the taxable year or period for wages, salaries, and other compensation of employees for the purpose of earning income in the regular course of business, plus the amounts received during the taxable year or period from gross sales, such expenses, purchases, and gross sales being limited to those attributable to the purchase of personal property within a possession of the United States and its sale within a possession of the United States; and partly from sources within the United States and partly from sources without the United States. The term "property" as used in this paragraph includes property held or used to produce income which is derived from such sales.

Case 3 B. Same as case 3 A.

Personal property purchased and sold. Gross income from the purchase of personal property within a possession of the United States and its sale within the United States shall be treated as derived partly from sources within the United States and partly from sources without the United States being that percentage of such net income which the number of days the ship was within the territorial limits of the United States bears to the total number of days the ship was in service during the taxable period. For other assets employed in the transportation business, the average of the assets at the beginning and end of the taxable period ordinarily may be taken, but if the average so obtained does not, by reason of material changes during the taxable year, fairly represent the average for such purpose, the asset employed in the transportation business in the United States or in total, the average must be determined upon a monthly or daily basis.

In computing net income from sources within the United States there shall be allowed as deductions from the gross income as determined in accordance with paragraph (a), (1) the expenses of transportation business carried on within the United States as determined under paragraph (a), and (2) the expenses determined in accordance with paragraph (b). Interest and income, war-profits, and excess-profits taxes should be excluded from the apportionment process, as explained in paragraph (a); but for the purpose of computing net income there may be deducted from the gross income from sources within the United States, after the amount of such gross income has been determined, a rate of (1) of all interest (except for the first section 23 (b)), and (2) of all income, war-profits, and excess-profits taxes (deductible under section 23 (c) and (d)), paid or accrued in respect of the transportation business within the United States and points outside the United States. Such rateable part should ordinarily be based upon the ratio of gross income from sources within the United States to the total gross income from such transportation service.

(d) If a foreign corporation subject to this section is also engaged in a business other than that of providing transportation service between points in the United States during the taxable year. Current assets should be decreased by current liabilities and allocated to services between the United States and foreign countries and to other services. The part allocated to services between the United States and foreign countries should be based on the proportion which the gross receipts from such services bear to the gross receipts from all services. The amount so allocated between the United States and foreign countries should be further allocated to services rendered within the United States and to services rendered without the United States. The portion allocable to services rendered within the United States should be based on the proportion which the expenses incurred within the territorial limits of the United States bear to the total expenses from sources within the United States and foreign countries. For ships the average should be determined upon a daily basis for each ship and the amount to be allocated to services within the United States should be computed upon the proportion which the number of days the ship was within the territorial limits of the United States bears to the total number of days the ship was in service during the taxable period. For other assets employed in the transportation business, the average of the assets at the beginning and end of the taxable period ordinarily may be taken, but if the average so obtained does not, by reason of material changes during the taxable year, fairly represent the average for such purpose, the asset employed in the transportation business in the United States or in total, the average must be determined upon a monthly or daily basis.

The property used should be apportioned on the same basis as direct revenues from transportation services.

In allocating the total costs or expenses incurred in such transportation business, costs incurred in connection with the transportation business, costs incurred in connection with that part of the services which was wholly rendered in the United States should be assigned to the cost of transportation business within the United States. Expenses of loading and unloading in the United States, rentals, office expenses, salaries, and wages wholly incurred for services rendered to the taxpayer in the United States, and expenses incurred in connection with services rendered partly within and partly without the United States may be prorated on a reasonable basis between such services. For example, ship wages, charter money, insurance, and supplies chargeable to voyage expenses should ordinarily be prorated for each voyage on the basis of the proportion which the number of days the ship was within the territorial limits of the United States bears to the total number of days of the voyage, income, war-profits, and excess-profits taxes should not be regarded as costs or expenses for the purpose of determining the proportion of gross income from sources within the United States; and such other expenses as are allowable deductions under the Internal Revenue Code shall be apportioned in accordance with paragraphs (c) and (d).
United States and points outside the United States, the costs and expenses (including taxes) properly apportioned or allocated to such other business should be excluded both from the deductions and from the apportionment process prescribed in paragraphs (a), (b), and (c), but, for the purpose of determining net income, a ratable part of any general expenses, losses, or deductions, which cannot definitely be allocated to some item or class of gross income, may be deducted from the gross income from sources within the United States after the amount of such gross income has been determined. Such ratable part should ordinarily be based upon the ratio which the amount of gross income from sources within the United States to the total gross income.

(c) Application for permission to base the return upon the taxpayer's books of account will be considered by the Commissioner in the case of any taxpayer subject to this section, who, in good faith and unaffected by considerations of tax liability employed in his books of account a detailed allocation of receipts and expenditures which reflects more clearly than the process prescribed in paragraphs (a) to (d), inclusive, the items of income from sources within the United States.

§ 29.119-14 Telegraph and cable service.

A foreign corporation carrying on the business of transmission of telegraph or cable messages between points in the United States and points outside the United States derives income partly from sources within and partly from sources without the United States.

(a) Gross income. The gross income from sources within the United States derived from such services shall be determined by adding (1) its gross revenues derived from messages originating in the United States and (2) amounts collected abroad on collect messages originating in the United States and deducting from such sums amounts paid or accrued for transmission of messages beyond the company's own circuit. Amounts remitted by the United States with respect to collect messages originating without the United States shall be excluded from gross income.

(b) Net income. In computing net income from sources within the United States there shall be allowed as deductions from gross income determined in accordance with paragraph (a), (1) all expenses incurred in the United States (not including any general overhead expenses) incident to the carrying on of the business in the United States, (2) all direct expenses (including wages paid in the transmission of messages originating in the United States (not including any general overhead expenses or maintenance, repairs, and depreciation of cables not included in the general overhead expenses (including wages paid in the transmission of messages originating in the United States and used in the trade or business therein, and (4) a proportion of the general overhead expenses (not including any items incurred abroad corresponding to those enumerated in (1), (2), and (3)) and of maintenance, repairs, and depreciation of cables of the entire cable system of the enterprise based on the ratio which the number of words originating in the United States bears to the total words transmitted by the enterprise.

§ 29.119-15 Computation of income.

If a taxpayer has gross income from sources within or without the United States as defined by section 119 (a) or (c) together with gross income derived partly from sources within and partly from sources without the United States, the amounts thereof, together with the expenses and investment applicable thereto, shall be segregated, and the net income from sources within the United States shall be separately computed therefrom.

§ 29.120-1 Unilateral deduction for charitable and other contributions.

Under the circumstances specified in section 120, the 15 percent limitation imposed by section 23 (a) on the deduction for charitable and other contributions is not applicable.

In the case of a husband and wife making a joint return for any taxable year, the 15 percent limitation on the deduction for contributions or gifts described in section 23 (a) shall not be applicable if the aggregate amount of the contributions or gifts described in section 23 (a) (or corresponding provisions of prior Revenue Acts) plus the amount of income, war-profits, or excess-profits taxes imposed for a taxable year in respect of preceding taxable years, exceeds 60 per centum of the taxpayer's net income for such each year, as computed without the benefit of any deduction for contributions or gifts.

§ 29.121-1 Deduction of dividends paid on certain preferred stock of certain corporations.

In computing the net income of any national banking association, or of any bank or trust company organized under the laws of any State, Territory, possession of the United States, or the Canal Zone, or of any other banking corporation engaged in the business of industrial banking and under the supervision of a State bank commissioner or of the Comptroller of the Currency, or of any incorporated domestic insurance company, there shall be allowed as a deduction from gross income, in addition to deductions otherwise provided for in this chapter, any dividend (not including any distribution in liquidation paid, within the taxable year, to the United States or to any instrumentality thereof exempt from Federal income taxes, on the preference stock owned by the United States or any such instrumentality. The amount allowable as a deduction under this section shall be deducted from the basic surplus credit otherwise computed under section 27 (b).

§ 29.122-1 Net operating loss deduction.

(a) Definition of net operating loss. As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the amount, with the exceptions, additions, and limitations provided in subsection (d).

(b) Carry-over and carry-back—Net operating loss carry-back. If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be the excess, if any, of the amount of such net operating loss over the amount of any net operating loss carried-back to the taxable year preceding such taxable year. If such preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the amount of any net operating loss carried-back to the taxable year preceding such taxable year shall be the excess, if any, of the amount of such net operating loss over the amount of any net operating loss carried-back to the taxable year preceding such taxable year.

(2) Net operating loss carry-over. If for any taxable year the taxpayer has a net operating loss, such net operating loss shall be the excess, if any, of the amount of such net operating loss over the amount of any net operating loss carried-back to the taxable year preceding such taxable year.

§ 29.123-1 Amount of net operating loss deduction.

The amount of the net operating loss deduction shall be the aggregate of the net operating losses carried-back to the taxable year reduced by the amount, if any, by which the net income (computed without such deduction) or, in the case of a corporation, the normal-tax net income (computed without such deduction) and without the credit provided in section 29 (c).

§ 29.124-1 Exceptions and limitations. The exceptions, additions, and limitations referred to in subsections (a), (b), and (c) shall be as follows:

(a) The deduction for depletion shall not exceed the excess of the net income over the amount of the net operating loss carry-backs from the taxable year reduced by the amount, if any, by which the net income (computed without such deduction) or, in the case of a corporation, the normal-tax net income (computed without such deduction) and without the credit provided in section 29 (c).

(b) There shall be included in computing gross income the amount of interest received which is wholly exempt from the taxes imposed by this chapter, decreased by the amount of interest paid or accrued which is not allowed as a deduction by section 29 (a) relating to interest on indebtedness incurred.
or continued to purchase or carry certain tax-exempt obligations;

(2) No net operating loss deduction shall be allowed;

(3) Gains and losses from sales or exchanges of capital or business property, not in the ordinary course of business, not in the ordinary course of business, shall be carried forward and/or to the taxable year in which the transaction took place without regard to the provisions of section 117 (b). As so computed the amount of the net operating loss carry-over to the extent of the amount of such losses shall not exceed the amount includible on account of such gains;

(4) Deductions otherwise allowed by law, not attributable to the operation of a trade or business regularly carried on by the taxpayer shall be allowed only to the extent of the amount of the gross income not derived from such trade or business. For the purposes of paragraph (d) such deduction, and gross income shall be computed with the exceptions and limitations specified in paragraphs (e) to (g) of this subsection.

(5) There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 3 paid or accrued within the taxable year, subject to the following rules:

- No reduction in such tax shall be made by reason of the credit for income, war profits, or taxes paid to any foreign country or possession of the United States;
- Such tax shall be computed without regard to the adjustment provided in section 764; and
- Such tax, in the case of a consolidated return for income tax purposes, shall be allocated to the members of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary.

(e) No carry-back to prior year prior to 1941. As used in this section, the term "preceding taxable year", as used in the meaning of "taxable year" do not include any taxable year beginning prior to January 1, 1941.

§ 29.122-2 Computation of net operating loss in case of corporation. A net operating loss is sustained by a corporation in any taxable year if and to the extent that, for such year, there is an excess of deductions allowed by chapter 1 over the income derived from such trade or business. The net operating loss deduction allowed in any taxable year shall be the amount of the excess of deductions allowed by chapter 1 over the income derived from such trade or business in such taxable year. The first succeeding taxable year to which it was carried back or over to any taxable year is the taxable year in the order of the taxable years from which such losses are carried back. If the net operating loss carry-over to the taxable year beginning on or after January 1, 1942, are the net operating loss for the first preceding taxable year and so much of the net operating loss for the second preceding taxable year has as not been absorbed by the net income (computed under section 122), if any, for the first preceding taxable year, and the net operating loss carry-back from such taxable year are the net operating loss for the second succeeding taxable year and such of the net operating loss for the first succeeding taxable year which has not been absorbed by the net income (computed under section 122), if any, for the first preceding taxable year. If either of the taxable years preceding the taxable year in which the deduction is allowed began on or after January 1, 1942, the net operating loss for such preceding taxable year is first reduced to the extent it has been absorbed by the net income (computed under section 122), if any, for the taxable years to which such loss has been carried back.

A fractional part of a year which is a taxable year under section 46 (a) is a preceding taxable year for the purpose of determining under section 122 the first, second, or third preceding taxable year or the first or second succeeding taxable year.

Every taxpayer claiming a net operating loss deduction for any taxable year shall file with his return for such year a concise statement setting forth the amount of the net operating loss deduction claimed and pertinent facts relative thereto, including a detailed schedule showing the computation of the net operating loss deduction.

(b) Section 29.122-2 Computation of net operating loss deduction. There are three steps in the ascertainment of the net operating loss deduction. The first step is the computation of the net operating loss, if any, for the two preceding taxable years and for the preceding taxable years. The second is the computation of the net operating loss carry-over to the taxable year from such preceding taxable years. The third is the conversion of the aggregate of such net operating loss carry-overs and carry-backs into the net operating loss deduction.

(c) Ascertainment of deduction dependent upon net operating loss carry-back. If the taxpayer is entitled in computing his net operating deduction to a carry-back which he is not able to ascertain at the time his return is due, he shall compute the net operating loss deduction on the return without regard to such net operating loss carry-back. When the taxpayer ascertains the net operating loss carry-back, he may within the applicable period of limitations file a claim for credit or refund of the overpayment, if any, resulting from the failure to compute the net operating loss deduction for the taxable year with the inclusion of such carry-back. Under the provisions of section 371 (e), no interest is allowed with respect to such overpayment for the period prior to the filing of the claim for credit or refund of such overpayment or prior to the filing of a petition with The Tax Court of the United States asserting such overpayment, whichever is earlier. If the taxpayer files a claim for credit or refund based on the overpayment caused by a carry-back from the first succeeding taxable year, and later ascertains that he is entitled to a carry-back from the second succeeding taxable year, he should file a second claim for credit or refund based on the overpayment, if any, caused by the failure to take into account the carry-back from such second succeeding taxable year.

§ 29.122-2 Computation of net operating loss in case of corporation. A net operating loss is sustained by a corporation in any taxable year if and to the extent that, for such year, there is an excess of deductions allowed by chapter 1 over the income derived from such trade or business. The net operating loss deduction allowed in any taxable year shall be the amount of the excess of deductions allowed by chapter 1 over the income derived from such trade or business. The first succeeding taxable year to which it was carried back or over to any taxable year is the taxable year in the order of the taxable years from which such losses are carried back. If the net operating loss carry-over to the taxable year beginning on or after January 1, 1942, are the net operating loss for the first preceding taxable year and so much of the net operating loss for the second preceding taxable year has as not been absorbed by the net income (computed under section 122), if any, for the first preceding taxable year, and the net operating loss carry-back from such taxable year are the net operating loss for the second succeeding taxable year and such of the net operating loss for the first succeeding taxable year which has not been absorbed by the net income (computed under section 122), if any, for the first preceding taxable year. If either of the taxable years preceding the taxable year in which the deduction is allowed began on or after January 1, 1942, the net operating loss for such preceding taxable year is first reduced to the extent it has been absorbed by the net income (computed under section 122), if any, for the taxable years to which such loss has been carried back.

A fractional part of a year which is a taxable year under section 46 (a) is a preceding taxable year for the purpose of determining under section 122 the first, second, or third preceding taxable year or the first or second succeeding taxable year.

Every taxpayer claiming a net operating loss deduction for any taxable year shall file with his return for such year a concise statement setting forth the amount of the net operating loss deduction claimed and pertinent facts relative thereto, including a detailed schedule showing the computation of the net operating loss deduction.

(b) Section 29.122-2 Computation of net operating loss deduction. There are three steps in the ascertainment of the net operating loss deduction. The first step is the computation of the net operating loss, if any, for the two preceding taxable years and for the preceding taxable years. The second is the computation of the net operating loss carry-over to the taxable year from such preceding taxable years. The third is the conversion of the aggregate of such net operating loss carry-overs and carry-backs into the net operating loss deduction.

(c) Ascertainment of deduction dependent upon net operating loss carry-back. If the taxpayer is entitled in computing his net operating deduction to a carry-back which he is not able to ascertain at the time his return is due, he shall compute the net operating loss deduction on the return without regard to such net operating loss carry-back. When the taxpayer ascertains the net operating loss carry-back, he may within the applicable period of limitations file a claim for credit or refund of the overpayment, if any, resulting from the failure to compute the net operating loss deduction for the taxable year with the inclusion of such carry-back. Under the provisions of section 371 (e), no interest is allowed with respect to such overpayment for the period prior to the filing of the claim for credit or refund of such overpayment or prior to the filing of a petition with The Tax Court of the United States asserting such overpayment, whichever is earlier. If the taxpayer files a claim for credit or refund based on the overpayment caused by a carry-back from the first succeeding taxable year, and later ascertains that he is entitled to a carry-back from the second succeeding taxable year, he should file a second claim for credit or refund based on the overpayment, if any, caused by the failure to take into account the carry-back from such second succeeding taxable year.

Example. For the year 1942 the X Corporation, which makes annual cost-of-goods sold on the calendar year basis, has gross income as defined in section 22 of $300,000 and deductions of $250,000. There were no other income or deduction items for this year. The corporation carried forward capital losses of $60,000 and short-term capital losses of $30,000, which are deductible to the extent of the capital gains, $75,000. The X Corporation also deducted $75,000 for...
depletion on a percentage basis. If depletion had been computed without reference to percentage depletion, the amount of such deduction would have been $5,000. For 1942 the X Corporation also had $35,000 of wholly tax-exempt interest, and paid $16,000 in interest on indebtedness incurred to carry the percentage depletion, the amount of such depletion on a percentage basis.

1942 of the year has a net operating loss for the year to discovery value or to percentage depletion, both computed with the following exceptions and limitations:

(1) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value or to percentage depletion under section 114 (b) (2), (3), or (4);

(2) There shall be included in computing gross income the amount of interest received which is wholly exempt from the taxes imposed by chapter 1, decreased by the amount of interest paid on accrued and foregone interest as a deduction by section 23 (b), relating to interest on indebtedness incurred or continued to purchase or carry certain tax-exempt obligations;

(3) No net operating loss deduction shall be allowed;

(4) Long-term capital gains and long-term capital losses shall be taken into account without regard to the percentage provisions of section 117 (b);

(5) For any taxable year beginning after December 31, 1938, and before January 1, 1942, the amount deductible on account of business long-term and short-term capital losses shall not exceed the amount includible on account of the business long-term and short-term capital gains, respectively, plus an allocable portion of any nonbusiness long-term and short-term capital gains, computed in accordance with paragraph (c) of this section;

Since the business short-term capital losses exceeded the business short-term capital gains by $1,600 (item 6), the $700 non-short-term capital loss is attributable to such excess. Similarly, $100 is attributable to an excess of nonbusiness short-term capital gains over the non-business short-term capital losses, respectively, i.e., $600 or $300 to the business short-term capital loss and $100 as a nonbusiness short-term capital loss.

Example 5 Assume the same facts as in the previous example except that the net short-term capital loss carry-over to 1942 from 1941 is only $350, because of the limitation contained in section 117 (d). Since six-sevenths ($600) of the $700 non-short-term capital loss for 1941 was attributable to an excess of business short-term capital losses over gains and one-seventh ($100) was attributable to an excess of nonbusiness short-term capital losses over gains, the $350 short-term capital loss carry-over from 1941 to 1942 shall be treated as a business short-term capital loss, and one-seventh, or $50, shall be treated as a nonbusiness short-term capital loss.
Since business capital losses exceeded business capital gains by $1,200 ($4,200 minus $3,000), $1,200 of the $1,400 net capital loss is attributable to an excess of nonbusiness capital losses over nonbusiness capital gains. Assuming that the net capital loss carry-over to 1944 from 1943 is also $1,400, the $1,200 will be treated as a business capital loss and $200 as a nonbusiness capital loss.

(c) Determination of portion of nonbusiness capital gains available for deduction of capital losses—(1) Taxable years beginning before 1942. In the computation of a net operating loss a taxpayer other than a corporation must, for taxable years beginning after December 31, 1938, and before January 1, 1942, first use his nonbusiness long-term and short-term capital gains for the deduction of his nonbusiness long-term and short-term capital losses, respectively. See paragraph (a) (6) of this section. Any amounts not necessary for this purpose shall then be used for the deduction of any excess of ordinary nonbusiness capital losses over ordinary nonbusiness gross income. See paragraph (a) (7) of this section. The remainder, computed by applying the excess ordinary nonbusiness deductions proportionally against the excess long-term and short-term capital gains, shall be treated as long-term and short-term capital gains, respectively, and may be used for the purpose of determining the deductibility of business long-term and short-term capital losses under paragraph (a) (5) of this section.

Example. A, an individual, has a total nonbusiness gross income of $20,500, computed as follows:

Ordinary gross income $7,500
Long-term capital gains 6,000
Short-term capital gains 6,000
Total gross income 20,500

He also has total nonbusiness deductions of $16,000, computed as follows:

Ordinary deductions 9,000
Long-term capital losses 2,000
Short-term capital losses 5,000
Total deductions 16,000

In order to determine the portion of the nonbusiness capital gains available for the deduction of business long-term and short-term capital losses there must first be deducted the amounts of the nonbusiness capital losses under paragraphs (a) (5) and (6) of this section. It is then possible that the excess long-term capital gains amount to $4,000 ($30,000 minus $26,000), and the excess short-term capital gains to $2,000 ($7,000 minus $5,000). Since the ordinary nonbusiness deductions exceed the ordinary nonbusiness gross income, by $1,000 ($9,000 minus $8,000), $1,000 of the $4,000 excess long-term and $2,000 excess short-term capital gains must be used to permit the allowance of such $1,000 under paragraph (a) (7) of this section. Therefore, $1,000 excess of ordinary deductions over ordinary gross income will be deducted from the $6,000 excess of capital gains, leaving $4,000 to be added to the business capital gains for the purpose of determining the deductibility of any business long-term capital losses.

(d) Illustration of computation of net operating loss by a taxpayer other than a corporation. A, an individual who makes his income tax returns on a calendar year basis, had net operating loss of $453,000 and deductions (exclusive of a net operating loss deduction) of $600,000 for 1942. Included in gross income are business long-term capital gains in the amount of $900,000. A has no other items of income or deductions to which section 122 (d) is applicable.

On the basis of the facts A has a net operating loss for 1942 of $110,000, computed as follows:

(1) Deductions for 1942, exclusive of capital losses: $1,000,000
(2) Plus amount of excess short-term capital losses: $200,000
(3) Sum of items (1) and (2): $1,200,000
(4) Less excess of nonbusiness deductions over nonbusiness gross income:
(a) $600,000
(b) $1,000,000
(c) $1,600,000
(5) Total deductions: $2,000,000
(6) Deductions adjusted as required by section 122 (d) (item 5) minus item (4): $500,000
(7) Gross income for 1942: $1,500,000
(8) Gross income adjusted as required by section 122 (d) (item 6) plus item (7): $2,000,000
(9) Net operating loss for 1942 (item 6 minus item (8)): $500,000

For treatment of depletion deductions and tax-free interest, see example in § 29.122-2. For treatment of net short-term capital loss carry-over, net capital loss carry-over, and nonbusiness capital gains and losses, and the portion of the nonbusiness capital gains which may be used to permit the deduction of business capital losses, see examples in paragraphs (b) and (c) of this section.

(e) Joint return by husband and wife. In the case of a husband and wife, the joint net operating loss for any taxable year for which a joint return is filed is to be computed upon the basis of the combined income and deductions of both spouses, and the exceptions and limitations prescribed by section 122 (d) are to be computed as if the combined income and deductions of both spouses were the income and deductions of one individual.

§ 29.122-4 Computation of net operating loss carry-overs and net operating loss carry-backs—(a) In general. The aggregate of any net operating loss carry-overs and any net operating loss carry-backs to a taxable year shall be the basis of the net operating loss carry-over to such year.
able years. The net operating loss for any taxable year beginning before January 1, 1942, may be carried over to the two succeeding taxable years, regardless of whether such year begins before, on, or after January 1, 1941. The amount which is so carried back or carried over to any taxable year is the net operating loss to the extent it was not absorbed in the computation of the net income for other taxable years, preceding such taxable year, to which it was carried back or carried over, in determining the net income for a taxable year which so absorbs the net operating loss that is carried back or carried over, the various net operating loss carryovers and carrybacks to any taxable year are considered to be applied in reduction of the net income for such taxable year in the order of the taxable years from which such losses are carried over or carried back, beginning with the loss for the earliest taxable year.

(b) Portion of net operating loss which is a carry-over or a carry-back to the current taxable year. If the net operating loss sustained in any taxable year beginning before January 1, 1942, may be carried over to the two succeeding taxable years. The entire net operating loss may be either the first succeeding taxable year, and the carry-over to the second succeeding taxable year is the excess of the net operating loss over the net income, if any, for the first succeeding taxable year, as computed in accordance with paragraph (c) of this section. For example, the taxpayer had a net operating loss of $10,000 in 1940. It had a 1941 net income of $6,000, computed as provided in paragraph (a) of this section. The carry-over from 1940 to 1942 is $4,000, the excess of the $10,000 loss over the $6,000 net income for 1941.

The net operating loss sustained in any taxable year beginning on or after January 1, 1942, may be carried back to the two preceding taxable years (not considering as a preceding taxable year a year beginning prior to January 1, 1941) and may be carried over to any of the two succeeding taxable years. The entire net operating loss may be carried back to the second preceding taxable year. However, if the second preceding taxable year began before January 1, 1941, no part of the net operating loss may be carried back to such taxable year, and the net income for such taxable year does not reduce the amount of the net operating loss which may be carried back or carried over to the other taxable years. The net operating loss, to the extent it exceeds the net income, if any (computed as provided in paragraph (c) of this section), for the second preceding taxable year, may then be carried back to the first preceding taxable year. To the extent the net operating loss exceeds the net income, if any (computed as provided in paragraph (c) of this section), for the two preceding taxable years, it may be carried over to the first succeeding taxable year. To the extent the net operating loss exceeds the aggregate of the net income, if any (computed as provided in paragraph (c) of this section), for the two preceding taxable years and for the first succeeding taxable year, it may be carried over to the second succeeding taxable year.

Example. The taxpayer has a net operating loss of $100,000 in 1943. It has net income, (computed as provided in paragraph (c) of this section), for 1941, $15,000; for 1942, $30,000, and for 1944, $80,000. The net operating loss carry-back from 1943 to 1941 is $60,000, an amount equal to the full net operating loss. The carry-back to 1942 is $50,000, the excess of the $100,000 net operating loss over the $50,000 net income for 1942, as provided in paragraph (c) of this section. The carry-over to 1944 is $100,000, the excess of the $100,000 net operating loss over the aggregate of the $180,000 net income for 1941 and the $150,000 net income for 1942 (computed in each instance as provided in paragraph (c) of this section). The carry-over to 1945 is $400,000, the excess of the $100,000 net operating loss over the aggregate of the $60,000 net income for 1941, the $180,000 net income for 1942, and the $300,000 net income for 1944 (computed in each instance as provided in paragraph (c) of this section).

(c) Computation of net income which is subject to a net operating loss deduction to determine carry-back or carry-over. The net income for any taxable year which is subject to the net operating loss deduction for another taxable year to determine the portion of such net operating loss which is a carry-back or carry-over to a particular taxable year as provided in paragraph (b) of this section is computed with the following adjustments:

(1) The net operating loss deduction for such taxable year is computed by taking into account only such net operating losses otherwise allowable as carry-over's or carry-backs to such taxable year which were sustained in taxable years preceding the taxable year in which the taxpayer sustained the net operating loss from which the net income is to be deducted.

Example. In computing the net operating loss deduction for 1945, the taxpayer has a carry-over from 1943 of $9,000, a carry-over from 1942 of $4,000, and $150,000 of income for 1944 of $180,000, and a carry-back from 1947 of $14,000, or an aggregate of $27,000 in carry-over's and carry-backs to such taxable year as a basis for the deduction. In computing the net income for 1945 which is deducted from the net operating loss for 1946 in order to determine the portion of such net operating loss which may be carried over to 1947 or 1948, the net operating loss deduction for 1945 is computed without taking into account the $14,000 carry-back from 1947 or the $14,000 carry-back from 1946. The net operating loss deduction for 1946 is computed without taking into account the $9,000 carry-over from 1945 and the $5,000 carry-over from 1944, or $12,000, adjusted as provided in § 29.122-5, relating to the computation of the aggregate of the net operating loss carry-overs and carry-backs to the taxable year into the net operating loss deduction. In computing the net income for 1945 which is deducted from the net operating loss for 1947 in order to determine the portion of such net operating loss which may be carried over to 1948 or 1949, the net operating loss deduction for 1947 is computed without taking into account the $14,000 carry-back from 1947, and as so computed is the aggregate of the $9,000 carry-over from 1945, the $6,000 carry-over from 1944, and the $18,000 carry-back from 1946, or $53,000, adjusted as provided in § 29.122-5.

(2) In the case of a corporation, the net income shall be computed in accordance with the first four exceptions, additions, and limitations applicable in the computation of a net operating loss deduction (see § 29.122-2), except that the net operating loss deduction shall be allowed to the extent provided in subparagraph (1) above.

(3) In the case of a taxpayer other than a corporation, the net income shall be computed in accordance with the first four exceptions, additions, and limitations specified in § 29.122-3 (a), except that the net operating loss deduction shall be allowed to the extent provided in subparagraph (1) above. In lieu of the three exceptions specified in § 29.122-3 (a), the taxpayer is required only (1) for a taxable year beginning before January 1, 1942, to restrict the amount of his deductions for long-term and short-term capital losses to the amount of his long-term and short-term capital gains, respectively, and (ii) for a taxable year beginning on or after January 1, 1942, to restrict the amount of his deduction for capital losses to the amount of his capital gains. The ordinary nonbusiness deductions are allowed in full or otherwise allowable by law. The exceptions and limitations dependent upon the distinction between business and nonbusiness items of gross income and deductions are not applicable in the computation of the net income to be subtracted in computing carry-backs and carry-overs.

(4) Any deduction which is limited in amount to a percentage of the taxpayer’s net income shall be recomputed upon the basis of the facts as finally determined in the adjustments provided in the preceding paragraphs.

(5) The net income, as adjusted, shall in no case be considered less than zero.

(d) Illustration of computation of net operating loss carry-backs and carry-overs. The application of this section may be illustrated by the following example:

Example. The taxpayer is a corporation, making the calendar year his taxable year. It sustained net operating losses as follows:

(a) In 1943 $35,000,
(b) In 1944 $25,000,
(c) In 1945 $40,000,
(d) In 1946 $20,000,
(e) In 1947 $15,000,
(f) In 1948 $15,000.

It had no net operating loss in 1939 or 1940, or in 1949 or 1950. Its net income, computed without any net operating loss deduction (it being assumed that none of the other adjustments provided in paragraph (c) of this section is applicable), was $20,000 in 1941, $30,000 in 1942, $50,000 in 1944, and $300,000 in 1946, and $80,000 in 1947. It sustained net operating losses as follows:

(a) $26,000 in 1942, $90,000 in 1944, and $300,000 in 1946, and $80,000 in 1947. It is assumed for the purposes of this example that the application of § 29.122-3 (b) to any one of the four exceptions, additions, and limitations specified in the aggregate of the net operating loss carry-overs and carry-backs to any taxable year, so that such aggregate is the net operating loss deduction for such taxable year.

(1) The portions of the $35,000 net operating loss for 1943 which may be used as carry-backs to 1941 and 1942 and as carry-overs to 1944 and 1945 are computed as follows:

(a) For 1941, the carry-back is $25,000, that is, the amount of the net operating loss for 1941 which is deductible from the excess of the $25,000 net operating loss over the $200,000 net income for 1941 (such net income being determined without any net operating loss deduction).

(b) For 1942, the carry-back is $6,000, that is, the excess of the $25,000 net operating loss over the $200,000 net income for 1941 (such net income being determined without any net operating loss deduction).
any net operating loss deduction since there is
no carry-over to 1941 from 1939 or 1940
and no carry-back from 1945, and the
carry-back from 1943 is not taken into
count).
(c) For 1944 and 1945, there is no carry-
over of the net operating loss for 1943 since
such loss does not exceed $50,000, the sum
of the net incomes of the taxable years
preceding 1943 computed as provided in
paragraph (c) of this section (the $20,000
net income for 1944 and the $30,000 net
income for 1945, there being no net operat-
ing loss deduction for either taxable year
since the carry-backs from 1943 and from 1944
are not taken into account).
(2) The portions of the $50,000 net op-
erating loss from 1944 which may be used as
carry-backs and carry-overs to 1945 and 1946.
(a) For 1942, the carry-back is $50,000,
that is, the amount of the net operating loss.
(b) For 1943, the carry-back is $20,000,
that is, the excess of the $50,000 net operat-
ing loss over the $30,000 net income for 1942,
and the $5,000 carry-back from 1945, the carry-back
from 1946 has not been taken into account.
(c) For 1944, the carry-over is $50,000, that
is, the excess of the $50,000 net operating loss
over $30,000, the sum of the $20,000 net in-
come for 1943 and the $30,000 net income for 1945
(computable with the deduction of the $5,000 carry-back from 1943 and without
the deduction of the carry-back from 1945)
(see examples for 1945 and 1946, in which a net operating loss was sustained). (d) For 1945, the carry-over is $50,000, that
is, the excess of the $50,000 net operating loss
over $50,000, the sum of the $30,000 net in-
come for 1944 and the $30,000 net income for 1946
(computable with the deduction of the $5,000
net income of the year 1945). In the manner set forth in the preceding
paragraphs, the joint net operating losses involved in the computation of a net
operating loss carry-over or net operat-
ing loss carry-back to such taxable year, the
joint net operating loss carry-over or joint net operating loss carry-back to
such taxable year is computed in the
same manner as the net operating loss
carry-over or net operating loss carry-
back of an individual under the preced-
ing paragraphs, but upon the basis of the Joint net operating losses and
the combined net income of both spouses.
If a husband and wife making a joint return for a taxable year made a joint
return for any or all of the taxable years
involved in the computation of a net operat-
ing loss carry-over or net operating loss carry-back to such taxable year, the
joint net operating loss carry-over or joint net operating loss carry-back to
such taxable year is computed in the
same manner as the net operating loss
carry-over or net operating loss carry-
back of an individual under the preced-
ing paragraphs, but upon the basis of the
Joint net operating losses and
the combined net income of both spouses.
If a husband and wife making separate
returns for a taxable year made a joint
return for any or all of the taxable years
involved in the computation of a net operat-
ing loss carry-over or net operating loss
carry-back of an individual under the preced-
ing paragraphs, but upon the basis of the
Joint net operating losses and
the combined net income of both spouses.

Example (1). H and W filed joint returns
for 1941 and 1942. They sustained a joint
operating loss of $1,000 for 1941 and a
joint net operating loss of $2,000 for 1942.
For 1941, the deductions of H exceeded his
gross income by $700, and the deductions of
W exceeded her gross income by $300, so
the total of such amounts being $1,000. There-
fore, $700 of the $1,000 joint net operating losses for 1941 is considered the net oper-
ating loss of H for 1941, and $300 of such joint net
operating loss is considered the net operating
loss of W for 1941. For 1942, the deductions of
H exceeded his gross income by $500, and the
deductions of W exceeded her gross income
by $500, so the total of such amounts being $1,000. There-
fore, $500 of the $2,000 joint net operating losses for 1942 is considered the
net operating loss of H for 1942, and $500 of such joint
net operating loss is considered the net operating
loss of W for 1942.

Example (2). H and W filed joint returns
for 1939 and 1941, and separate returns for
1940 and 1942. For such years they had net
incomes and net operating losses as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Income</th>
<th>Loss</th>
<th>Net Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1939</td>
<td>$5,000</td>
<td>$2,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>1940</td>
<td>$4,000</td>
<td>$1,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>1941</td>
<td>$2,000</td>
<td>$2,000</td>
<td>$0</td>
</tr>
<tr>
<td>1942</td>
<td>$5,000</td>
<td>$4,000</td>
<td>$1,000</td>
</tr>
</tbody>
</table>

\[1 \text{ Net. Inc.} \times \text{ Loss. Out.} \times \text{ Combined Income.}

The net operating loss carry-over of H from
1942 to 1943 is $4,000, that is, his $4,000 net
operating loss for 1942 which is not reduced by
any part of the net income for 1941, since
none of such income is attributable to H and
the portion attributable to W is entirely
deductible by her separate net operating loss deduction for her taxable year 1942, which
taxable year begins on the same date as H's
taxable year 1942. The determination of
the amount (60) of net income for 1941 which reduces H’s net operating loss for 1942 is made as follows:

The combined net income of $9,500 for 1941 is reduced to $5,000 by the non-operating loss deduction for such year of $4,500. This net operating loss deduction is computed without taking into account any net operating loss sustained in the taxable year beginning on or after January 1, 1942, the date of the beginning of the taxable year in which H sustained the net operating loss (see the preceding paragraphs of this section). Since all of such net income is attributable to H, the resulting net income attributable to H is $5,000.

The net operating loss carry-over of W from 1942 to 1943 is $500, her $1,000 loss reduced by the $500 net income for 1941, computed in the manner prescribed in the preceding paragraphs of this section, is attributable to her. W’s net operating loss for 1942 is $500, her $1,000 net operating loss for 1942, her net income for 1942 of $500, her $1,000 loss reduced by the $500 net income for 1941, computed in the manner prescribed in the preceding paragraphs of this section, is attributable to her. W’s net operating loss for 1942 is $500, her $1,000 net operating loss for 1942, her net income for 1942 of $500, her $1,000 loss reduced by the $500 net income for 1941, computed in the manner prescribed in the preceding paragraphs of this section, is attributable to her.

Example (2). Assume the same facts as in example (1) except for 1941, the net operating loss of W for 1942 is $500 instead of $1,000. The net operating loss carry-over of W from 1942 to 1943 is $200, her $500 loss reduced by the $200 net income for 1941, computed in the manner prescribed in the preceding paragraphs of this section, is attributable to her. W’s net operating loss for 1942 is $200, her $500 net operating loss for 1942, her net income for 1942 of $200, her $500 loss reduced by the $200 net income for 1941, computed in the manner prescribed in the preceding paragraphs of this section, is attributable to her.

Example (3). Assume the same facts as in example (1), except for 1941, the net operating loss of W for 1942 is $500 instead of $1,000. The net operating loss carry-over of W from 1942 to 1943 is $200, her $500 loss reduced by the $200 net income for 1941, computed in the manner prescribed in the preceding paragraphs of this section, is attributable to her. W’s net operating loss for 1942 is $200, her $500 net operating loss for 1942, her net income for 1942 of $200, her $500 loss reduced by the $200 net income for 1941, computed in the manner prescribed in the preceding paragraphs of this section, is attributable to her.

The net operating loss carry-over of W from 1942 to 1943 is $200, her $500 loss reduced by the $200 net income for 1941, computed in the manner prescribed in the preceding paragraphs of this section, is attributable to her.

The combined net income for 1941, computed with the net operating loss deduction in the manner described in example (2), remains $1,000, no part of which is attributable to her. To the $500 net income attributable to H there is added $800, the excess of the $1,000 net income attributable to W over its $200 net operating loss sustained in 1942, a taxable year beginning on the same date (January 1, 1942) as the taxable year of H (1942) in which he sustained the net operating loss from which the net income is subtracted. See paragraph (2)(iv) above.

W has no net operating loss carry-over from 1942 to 1943, her $500 operating loss reduced by $200 of the net income for 1941, computed as follows:

The combined net income for 1941, computed with the net operating loss deduction in the manner described in example (2), remains $1,000, no part of which is attributable to her. To the $500 net income attributable to H there is added $800, the excess of the $1,000 net income attributable to W over its $200 net operating loss sustained in 1942, a taxable year beginning on the same date (January 1, 1942) as the taxable year of H (1942) in which he sustained the net operating loss from which the net income is subtracted. See paragraph (2)(iv) above.

W has no net operating loss carry-over from 1942 to 1943, her $500 operating loss reduced by $200 of the net income for 1941, computed as follows:

The combined net income for 1941, computed with the net operating loss deduction in the manner described in example (2), remains $1,000, no part of which is attributable to her. To the $500 net income attributable to H there is added $800, the excess of the $1,000 net income attributable to W over its $200 net operating loss sustained in 1942, a taxable year beginning on the same date (January 1, 1942) as the taxable year of H (1942) in which he sustained the net operating loss from which the net income is subtracted. See paragraph (2)(iv) above.

W has no net operating loss carry-over from 1942 to 1943, her $500 operating loss reduced by $200 of the net income for 1941, computed as follows:

The combined net income for 1941, computed with the net operating loss deduction in the manner described in example (2), remains $1,000, no part of which is attributable to her. To the $500 net income attributable to H there is added $800, the excess of the $1,000 net income attributable to W over its $200 net operating loss sustained in 1942, a taxable year beginning on the same date (January 1, 1942) as the taxable year of H (1942) in which he sustained the net operating loss from which the net income is subtracted. See paragraph (2)(iv) above.

W has no net operating loss carry-over from 1942 to 1943, her $500 operating loss reduced by $200 of the net income for 1941, computed as follows:

The combined net income for 1941, computed with the net operating loss deduction in the manner described in example (2), remains $1,000, no part of which is attributable to her. To the $500 net income attributable to H there is added $800, the excess of the $1,000 net income attributable to W over its $200 net operating loss sustained in 1942, a taxable year beginning on the same date (January 1, 1942) as the taxable year of H (1942) in which he sustained the net operating loss from which the net income is subtracted. See paragraph (2)(iv) above.

W has no net operating loss carry-over from 1942 to 1943, her $500 operating loss reduced by $200 of the net income for 1941, computed as follows:

The combined net income for 1941, computed with the net operating loss deduction in the manner described in example (2), remains $1,000, no part of which is attributable to her. To the $500 net income attributable to H there is added $800, the excess of the $1,000 net income attributable to W over its $200 net operating loss sustained in 1942, a taxable year beginning on the same date (January 1, 1942) as the taxable year of H (1942) in which he sustained the net operating loss from which the net income is subtracted. See paragraph (2)(iv) above.

W has no net operating loss carry-over from 1942 to 1943, her $500 operating loss reduced by $200 of the net income for 1941, computed as follows:

The combined net income for 1941, computed with the net operating loss deduction in the manner described in example (2), remains $1,000, no part of which is attributable to her. To the $500 net income attributable to H there is added $800, the excess of the $1,000 net income attributable to W over its $200 net operating loss sustained in 1942, a taxable year beginning on the same date (January 1, 1942) as the taxable year of H (1942) in which he sustained the net operating loss from which the net income is subtracted. See paragraph (2)(iv) above.
Section 128. Commodity credit loans [as added by sec. 302 (a), Rev. Act 1939, and amended by sec. 154 (a), Rev. Act 1942].

(a) Amounts received as loans from the Commodity Credit Corporation shall, with the consent of the taxpayer and the Commodity Credit Corporation, be included in gross income of the taxpayer for the taxable year in which received, unless he secures the consent of the Commissioner to a different method of accounting.

(b) The consent provided for in subsection (a) may be revoked by the taxpayer at any time prior to, or at any time after the expiration of the time prescribed for the filing of such consent. If consent is revoked within the taxable year of the taxpayer beginning in 1942, for the taxable year in which received.

(c) The election provided for in subsection (a) with respect to taxable years beginning after December 31, 1938, and before January 1, 1942, may be made by the taxpayer at any time prior to the time prescribed for the filing of such consent.

Section 129. Election to include loans in income. A taxpayer who receives a loan from the Commodity Credit Corporation may, at his election, include the amount of such loan in his gross income for the taxable year in which the loan is received. If a taxpayer makes such an election, then for subsequent taxable years he shall include in his gross income all amounts received during those years as loans from the Commodity Credit Corporation, unless he secures the permission of the Commissioner of Internal Revenue to adopt a different method of accounting. Application for permission to change such method of accounting and the basis upon which such application is made shall be made within 90 days after the beginning of the taxable year to be covered by the permission.

Subsection (a) of this subsection occurs within sixty months from the beginning of such taxable year. If such application is approved, the taxpayer shall be allowed a deduction for the deficiency realized by the Commodity Credit Corporation on such loan if the taxpayer was relieved from liability for such deficiency by reason of the election of the taxpayer to take the amortization deduction. The election to take the amortization deduction provided in subsection (a) may, at any time after making such election, determine the amortization period with respect to the commodity pledged for such loan in a manner provided in section 123 (b) or (c) of the Revenue Act of 1942.

Section 130. Termination of amortization deduction. A taxpayer which has elected to take the amortization deduction provided in subsection (a) shall (1) be made, only if the date of the proclamation or the date specified in such certificate occurs after the expiration of sixty months from the beginning of such taxable year if such taxpayer has elected under section 123 (c) of the Revenue Act of 1942 to take the amortization deduction. The election to take the amortization deduction provided in subsection (a) may, at any time after making such election, change the amortization period with respect to the commodity pledged for such loan in a manner provided in section 123 (b) or (c) of the Revenue Act of 1942.

Section 131. Termination of amortization period. (1) If the President has proclaimed the ending of the emergency period (as defined in subsection (a) of this section), or if the Secretary of War or the Secretary of the Navy has, in accordance with regulations prescribed by the President, in lieu of the amortization deduction provided in section 123 (b) or (c) of the Revenue Act of 1942, provided for in subsection (a) of this section, the deduction provided in subsection (a) of this section shall terminate as of the date of the proclamation or in which the emergency facility ceased, on the date specified in such certificate. If such certificate is not issued within sixty months from the beginning of such taxable year or if the date of such proclamation or the date specified in such certificate occurs after the expiration of sixty months from the beginning of such taxable year, the taxpayer may elect (in accordance with paragraph (4) of this subsection) to take in gross income the sum of $100 for each month in which such emergency facility was completed or acquired, or the succeeding taxable year.

(2) If the date of the proclamation or the date specified in such certificate occurs after the expiration of sixty months from the beginning of such taxable year, or if the date of such proclamation or the date specified in such certificate occurs after the expiration of sixty months from the beginning of any subsequent taxable year, the taxpayer may elect to take the amortization deduction for such taxable year, provided that the date of the proclamation or the date specified in such certificate is prior to or on the date on which such emergency facility was completed or acquired, and that the election to take the amortization deduction was made by filing with the Secretary of the Treasury a statement to that effect in its return for the taxable year in which the emergency facility ceased, or in the taxable year in which such emergency facility was completed or acquired, or in which the date specified in such certificate occurred, whichever is the earlier.

(3) If the date of the proclamation or the date specified in such certificate occurs after the expiration of sixty months from the beginning of such taxable year, or if such certificate is not issued within sixty months from the beginning of such taxable year, or if the date of such proclamation or the date specified in such certificate occurs after the expiration of sixty months from the beginning of such taxable year, or if the date of such proclamation or the date specified in such certificate occurs after the expiration of sixty months from the beginning of any subsequent taxable year, the taxpayer may elect to take the amortization deduction for such taxable year, and for each of the succeeding taxable years, in which such emergency facility was completed or acquired, or in which the date specified in such certificate occurred, whichever is the earlier. In such case the amortization period with respect to such emergency facility shall end with the end of such year. The deduction provided in section 123 (b) or (c) of the Revenue Act of 1942 shall be disregarded.

(4) In the case of a taxpayer which has elected under section 123 (b) or (c) of the Revenue Act of 1942 to take the amortization deduction for such taxable year, the election to take the amortization deduction may be revoked within sixty months from the beginning of such taxable year, or within sixty months from the date of the proclamation or of the date specified in such certificate, whichever is the earlier.

(5) In the case of a taxpayer which has previously elected to take the amortization deduction for such taxable year, the election to take the amortization deduction may be revoked within sixty months from the date of the proclamation or of the date specified in such certificate, whichever is the earlier. In such case the amortization period with respect to such emergency facility shall end with the end of such year. The deduction provided in section 123 (b) or (c) of the Revenue Act of 1942 shall be disregarded.

(6) The election provided in paragraph (4) may be revoked within sixty months from the date of the proclamation or of the date specified in such certificate, whichever is the earlier.
and within such time, as the Commissioner with the approval of the Secretary may by regulations prescribe, a statement of such election. When such statement is made, then, under regulations prescribed by the Commissioner with the approval of the Secretary, the taxes for all taxable years, beginning with the expiration of the amortization period, shall be computed in accordance with an amortization deduction computed in accordance with the provisions of substantially the same certificate as provided in subsection (a), but using in lieu of the sixty-month-period provided in such subsection, the construction, reconstruction, erection, installation, or acquisition of which was completed after December 31, 1939, and with respect to which a certificate under subsection (f) has been made. For the purposes of this section, the part of any facility which was constructed, reconstructed, erected, or installed prior to December 31, 1939, and not earlier than six months prior to the filing of an application for a certificate under subsection (b) with respect to which a certificate under subsection (f) has been made, shall be deemed to be an emergency facility and to have been constructed, reconstructed, erected, or installed earlier than six months prior to the filing of such application. For the purposes of this section, the part of any facility which was constructed, reconstructed, erected, or installed by or before December 31, 1939, and before June 11, 1940, and with respect to which a certificate under subsection (f) has been made, shall be deemed to be an emergency facility and to have been completed on June 10, 1940, notwithstanding that the entire facility was not completed until after June 10, 1940.

(2) Emergency period. As used in this section, the term "emergency period" means the period beginning January 1, 1941, and ending on the date on which the President proclaims that the utilization of a substantial portion of an emergency facility is necessary in the interest of national defense.

(3) Determination of adjusted basis of emergency facility. In determining, for the purposes of subsection (a) or subsection (b), the adjusted basis of an emergency facility:

(1) There shall be included only so much of the amount otherwise constituting such adjusted basis as is properly attributable to such construction, reconstruction, erection, installation, or acquisition after December 31, 1939, as either the Secretary of War or the Secretary of the Navy has certified as necessary in the interest of national defense.

(2) After the completion or acquisition of any emergency facility with respect to which a certificate under paragraph (1) has been made, any expenditure attributable to such facility and to the period after such completion or acquisition which does not represent construction, reconstruction, erection, installation, or acquisition included in such certificate, but with respect to which a separate certificate is made under paragraph (1), shall not be applied in adjusting the adjusted basis of such facility and shall be considered as an expenditure with respect to a new emergency facility.

(3) The certificate provided for in paragraph (1) shall have no effect unless an application therefor is filed before the expiration of six months after the beginning of such construction, reconstruction, erection, installation, or the date of such acquisition, or before December 1, 1941, whichever is later, except that—

(A) in the case of an emergency facility completed or acquired before December 31, 1939, by a person other than a corporation, such certificate shall have no effect unless an application therefor is filed before the expiration of six months after the beginning of such construction, reconstruction, erection, installation, or the date of such acquisition, or before the expiration of six months after the date of enactment of the Revenue Act of 1942, whichever is later.

In no event and notwithstanding any of the other provisions of this section, no amortization deduction shall be allowed in respect of any emergency facility for any taxable year.

(C) unless a certificate in respect thereof under paragraph (1) shall have been made (i) prior to the filing of the taxpayer's return for such taxable year, or (ii) prior to the making of an election under subsection (d) or subsection (e).

(D) in the case of an emergency facility completed or acquired by a corporation after December 31, 1939, unless a certificate in respect thereof under paragraph (1) shall have been made prior to the expiration of six months after the date of enactment of the Revenue Act of 1942;

(E) in the case of an emergency facility completed or acquired after December 31, 1939, and before January 1, 1943, by a person other than a corporation, unless a certificate in respect thereof under paragraph (1) shall have been made (i) prior to the expiration of nine months after the last date upon which an application for such certificate may be filed, or (ii) prior to the expiration of twelve months after the date of enactment of the Revenue Act of 1942, whichever is later.

(g) Depreciation deduction. In the case of an adjusted basis of the emergency facility computed without regard to subsection (f) of this section, the tax on such amount (except in the case of an emergency facility for which the filing of such notice of determination has been made, or for payment, as the case may be, within one year after the date of the mailing of such notice of determination) shall be charged to the account of the taxpayer's election under this subsection, or installation or the date of such acquisition, or before the expiration of six months after the date of enactment of the Revenue Act of 1942, whichever is later.

The amortization deduction for the month in which an amount is includible shall be the amount (in lieu of the amount of the deduction for such month computed under subsection (a)) be the amount so includible, but such deduction shall not be in excess of the adjusted basis of the emergency facility as of the end of such month (computed without regard to the amortization deduction for such month). Payments referred to in this paragraph shall be made in an amount certified by the Secretary of War or the Secretary of the Navy as compensation to the taxpayer for the unamortized cost of the emergency facility made necessary in the interest of national defense.

(A) A contract with the United States involving the use of the facility, or from written or oral representations made under authority of the United States for anticipating future contracts involving the use of the facility, which future contracts have not been made.

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(2) In the case the taxpayer is not entitled to any amortization deduction with respect to the emergency facility in the amortization period allowable under section 23 (1) on account of such month as is so includable shall be increased by such amount, but such deduction on account of such month shall not be in excess of the adjusted basis of the emergency facility, or (2) in the amortization period (computed without regard to any amount allowable, on account of such month, under section 124), the Secretary of the department concerned makes the required certification of necessity, the deduction shall be allowable under section 124 (d) (6) to the Secretary of the department concerned that a facility is necessary in the interest of national defense during the emergency period as the law allows.

§ 29.124-0 Definitions. As used in this section and §§ 29.124-1 to 29.124-9, inclusive, the terms:

(a) "Secretary of the department concerned" means the Secretary of War or the Secretary of the Navy, as the case may be.

(b) "Emergency facility" means any facility, land, building, machinery, or equipment, or any part thereof:

(1) The acquisition of which occurred after December 31, 1939, or the construction, reconstruction, erection, or installation of which was completed after such date, and

(2) Any part of the construction, reconstruction, erection, installation, or acquisition of which has, under such regulations as may be prescribed by the Secretary of War and the Secretary of the Navy, with the approval of the President, been certified by the Secretary of the department concerned as necessary in the interest of national defense during the emergency period.

The part of any facility which is constructed, reconstructed, erected, or installed by any person after December 31, 1939, and not earlier than six months prior to the filing of an application for a certificate of necessity under section 124 (d), and which is certified by the Secretary of the department concerned as necessary in the interest of national defense during the emergency period shall be deemed to be an emergency facility, notwithstanding that the other part of such facility was constructed, reconstructed, erected, or installed earlier than such six month period, and in so far as such application. If the construction, reconstruction, erection, or installation of a facility by a corporation is begun before June 11, 1940, and completed after June 10, 1940, the part of such facility which is constructed, reconstructed, erected, or installed after December 31, 1939, and before June 1, 1940, shall be deemed to be an emergency facility, provided such part is certified by the Secretary of the department concerned as necessary in the interest of national defense during the emergency period.

The "emergency facility," as so defined, may include, among other things, improvements of land, such as the construction of airports and the dredging of channels.

(c) The "emergency period" means the period beginning on January 1, 1940, and ending on the date on which the President proclaims that the utilization of a substantial portion of the emergency facilities is no longer required in the interest of national defense.

§ 29.124-1 Certificate of necessity. The certification by the Secretary of the department concerned that a facility is necessary in the interest of national defense during the emergency period shall have no effect:

(a) In the case of an emergency facility completed or acquired by a corporation after June 10, 1940, unless an application therefor is filed before the expiration of six months after the beginning of the construction, reconstruction, erection, or installation of such facility, or the date of its acquisition, or before December 1, 1941, whichever is later (see §29.124-0 (b));

(b) In the case of an emergency facility completed or acquired by a corporation after December 31, 1939, and before June 11, 1940, unless an application therefor is filed before April 22, 1940;

(c) In the case of an emergency facility completed or acquired after December 31, 1939, by a corporation after December 31, 1939, and before June 11, 1940, unless an application therefor is filed before the expiration of six months after the conclusion of the construction, reconstruction, erection, or installation of such facility, or the date of its acquisition, or before April 22, 1943, whichever is later.

§ 29.124-2 Amortization deduction; general rule. If the Secretary of the department concerned makes the required certification of necessity, a person is entitled, at its election, to a deduction with respect to the amortization of the adjusted basis of an emergency facility, such amortization to be based generally on a period of 60 months. As to the adjusted basis of an emergency facility, see §29.124-4. The taxpayer may, with respect to a facility, elect to begin the 60-month amortization period with (1) the month following the month in which such facility was completed or acquired, or (2) the taxable year subsequent to the month in which such facility was completed or acquired. See §29.124-3.

The date on which, or the month within which, an emergency facility is completed or acquired is a question to be determined by the facts and circumstances of the particular case. Ordinarily the taxpayer is in possession of all the facts and, therefore, in a position to ascertain such date. A statement of the date ascertained by the taxpayer, together with a statement of the pertinent facts relied upon, should be filed with the taxpayer's election to take amortization deductions with respect to such facility. If the construction, reconstruction, erection, or installation of an emergency facility by a corporation is begun before June 11, 1940, and completed after June 10, 1940, the part of such facility which is constructed, reconstructed, erected, or installed after December 31, 1939, and before June 11, 1940, shall be deemed to have been complete by June 10, 1940.

If the Secretary of the department concerned makes the required certification of necessity, a corporation which has under such regulations as may be prescribed by the Secretary of the department concerned that a facility is necessary in the interest of national defense during the emergency period is to be deemed to be an emergency facility, notwithstanding that the other part of such facility was constructed, reconstructed, erected, or installed earlier than such six month period, and in so far as such application.
such facility for the taxable year 1942 is $12,000, computed as follows:

Monthly amortization deductions:  
October ($230,000 + 50) $4,000  
November $390,000  
December $320,000, or $390,000 minus $4,000 = 50) 4,000

Total amortization deduction for 1942 $12,000.

Example (2). The Z Corporation, which makes its income tax returns on the basis of a fiscal year ending November 30, purchases an emergency facility (No. 1) on July 29, 1943. On June 15, 1943, the Corporation elects to take amortization deductions with respect to such facility and to begin the 60-month amortization period with the taxable year 1943, which is completed on August 2, 1943. The entire acquisition and construction of such facilities are certified as necessary in the interest of national defense. The Z Corporation elects to take amortization deduction with respect to both facilities and to begin the 60-month amortization period in each case with the month following the month of acquisition or completion. The adjusted basis of facility No. 1 is $300,000, and the adjusted basis of facility No. 2 is $50,000 at the end of the first month of the 60-month period. In September 1943, facility No. 1 is damaged by fire, as a result of which its adjusted basis is properly reduced by $25,000. The allowable amortization deduction with respect to such facilities for the taxable year ending November 30, 1943, is $21,410, computed as follows:

Facility No. 1  
Amortization deduction for 1943 $18,710  
Total amortization deduction for 1943 $21,410

Facility No. 2  
Amortization deduction for 1943 $3,700

The allowable amortization deduction with respect to such facility for the taxable year 1941, similarly computed, is $15,000, or $2,000. Accordingly, the adjusted basis of such facility at the end of January 1942 (without regard to the amortization deduction for such month, or any subsequent amortization deductions) is $250,000, or $2,000. For the taxable year 1943, the Z Corporation elects to take an amortization deduction of $25,000, computed as follows:

Monthly amortization deductions:  
September ($350,000 minus $4,000) = 50) $4,000  
October $390,000  
November $355,000 minus $4,000 = 50) 4,000

Total amortization deduction for 1943 $25,000.

Example (3). On June 15, 1941, the Z Corporation, which makes its income tax returns on the calendar year basis, completes the construction of an emergency facility at a cost of $130,000. In its income tax return for 1940, the Corporation, in its return for the fiscal year 1940, at a cost of $174,000, is damaged by fire, as a result of which its adjusted basis is properly reduced by $24,000. The allowable amortization deduction with respect to such facility for the taxable year 1940 is $21,410, computed as follows:

Total amortization deduction for 1940 $21,410.

Example (4). On March 18, 1940, the B Corporation, which makes its income tax returns on the calendar year basis, completes the construction of a facility which is completed or acquired shall be made only if its return for the tax year in which such facility was completed or acquired; and

(b) An election by the taxpayer to take amortization deductions with respect thereto and to begin the 60-month amortization period with the taxable year succeeding that in which such facility was completed or acquired shall be made only by a statement in writing to that effect filed with the Commissioner of Internal Revenue, Washington, D.C., before April 22, 1940.

In the case of an emergency facility completed or acquired (1) after December 31, 1939, and before June 11, 1940, by a corporation, or (2) after December 31, 1941, by a person other than a corporation, an election by the taxpayer to take amortization deductions with respect thereto and to begin the 60-month amortization period either with the month following the month of completion or acquisition or with the following taxable year shall be made only by a statement in writing to that effect filed with the Commissioner of Internal Revenue, Washington, D.C., before April 22, 1940.

No other method of making such elections is permitted. Any statement of election should contain a description clearly identifying each emergency facility for which an amortization deduction is claimed.

A taxpayer which does not elect, in the manner provided in section 124 (b), to take amortization deductions with respect to an emergency facility shall not, except as provided in sections 124 (d) and (g) and 124A, disallow any amortization deduction with respect to such facility (see § 29.124-5 (d)).
in writing filed with the Commissioner specifying the month as of the beginning of which the taxpayer elects to discontinue the deductions. Such notice shall be filed before the beginning of the month for which the taxpayer desires to discontinue the amortization deductions with respect to an emergency facility. If the taxpayer so elects to discontinue the amortization deductions with respect to an emergency facility, it shall not, except as provided in section 124 (d), be entitled to any further amortization deductions with respect to such facility (see § 29.124-5 (c)).

A taxpayer which thus elects to discontinue amortization deductions with respect to an emergency facility is entitled to the full amount of the deductions with respect to such facility. The certificate of discontinuance proceedings with respect to such facility may be made in the manner provided in paragraph (b) of this section to terminate the amortization period with respect to such facility if the taxpayer elects to discontinue the amortization deductions with respect to such facility as of the end of the month in which occurs the date the emergency use ceases, provided that such date occurs prior to the expiration of the original 60-month period. In such case there shall, with respect to such facility, be substituted, in lieu of the original 60-month period, a new amortization period beginning with the end of the month in which the original 60-month period began, shall be computed (or recomputed) so as to give effect to amortization deductions with respect to such facility beginning with the end of the month in which occurs the date the emergency use ceases, and the taxpayer’s taxes for all taxable years (beginning with the taxable year in which the original 60-month period began) shall be computed (or recomputed) so as to give effect to amortization deductions with respect to such facility computed in the manner provided in sections 124 (a) (see § 29.124-2) but on the basis of the new amortization period.

Example. On July 1, 1942, the X Corporation, which makes its income tax returns on the calendar year basis, acquired for cash a new emergency facility, consisting of land with a basis of $600,000, and a building thereon, at a cost of $306,000, of which $180,000 is allocable to the land, and $126,000 to the building. The certificate of necessity covers the entire acquisition. The corporation elects to take amortization deductions with respect to the facility beginning with the first month of the amortization period, which is June 1, 1942. On March 30, 1944, the corporation files notice with the Commissioner of its election to terminate the amortization period as of May 31, 1944, which is the date of the expiration of the original 60-month period and ending with the end of the month in which occurs the date the emergency use ceases, and to discontinue the amortization deductions with respect to such facility beginning with the end of the month in which the original 60-month period began, shall be computed (or recomputed) so as to give effect to amortization deductions with respect to such facility computed in the manner provided in sections 124 (a) (see § 29.124-2) but on the basis of the new amortization period.

Example. On August 16, 1942, the X Corporation, which makes its income tax returns on the calendar year basis, acquired for cash an emergency facility for the purpose of performing War Department contracts. The corporation elects to take amortization deductions with respect to such facility beginning with the first month of the amortization period, which is June 1, 1942. On January 1, 1943, the corporation files notice with the Commissioner that such facility ceased to be necessary in the interest of national defense. The corporation elects to discontinue the amortization deductions with respect to such facility, beginning with the end of the month in which such facility ceased to be necessary. The corporation may elect, in the manner provided in section 124 (a) (see § 29.124-2) but on the basis of the new amortization period.

§ 29.124-5 Termination of amortization period—(a) Date the emergency use ceases. As used in this section, the term 'date the emergency use ceases' means whichever of the following is the earlier:

(1) The date of the proclamation by the President by reason of which the emergency period ends; or

(2) The date specified in a certificate with respect to an emergency facility made to the Commissioner by the Secretary of the department concerned (in accordance with regulations prescribed by the President) as the date at which such facility ceased to be necessary in the interest of national defense during the emergency period.

(b) Taxpayer which has elected to amortize. A taxpayer which has elected to take amortization deductions with respect to an emergency facility may elect, in the manner provided in paragraph (c) of this section to terminate the amortization period with respect to such facility as of the end of the month in which occurs the date the emergency use ceases, provided that such date occurs prior to the expiration of the original 60-month period. In such case, with respect to such facility, the election to discontinue the amortization deductions shall be disregarded and there shall be substituted, in lieu of the original 60-month period, a new amortization period beginning with the first month of the original 60-month period and ending with the month in which occurs the date the emergency use ceases. The taxpayer’s taxes for all taxable years (beginning with the taxable year in which the original 60-month period began) shall be computed (or recomputed) so as to give effect to amortization deductions with respect to such facility computed in the manner provided in section 124 (a) but on the basis of the new amortization period.

Example. On November 1, 1942, the X Corporation, which makes its income tax returns on the calendar year basis, acquired for cash a new emergency facility which is completed on March 15, 1943. The corporation elects to take amortization deductions with respect to such facility and to begin the 60-month amortization period with April 15, 1943, the month following the completion. On January 15, 1944, the corporation files a certificate with the Commissioner in which it elects to discontinue the amortization deductions with respect to such facility as of the beginning of the month in which occurs the date the emergency use ceases, and to discontinue the amortization deductions with respect to such facility computed in the manner provided in sections 124 (a) (see § 29.124-2) but on the basis of the new amortization period.

§ 29.125-1 Determination of contract price—(a) General rules. A contractor which has elected to amortize taken under § 29.125-2 shall be disregarded and there shall be substituted, in lieu of the original 60-month period, a new amortization period beginning with the first month of the original 60-month period and ending with the period in which occurs the date the emergency use ceases. The contractor’s taxes for all taxable years (beginning with the taxable year in which the original 60-month period began) shall be computed (or recomputed) so as to give effect to amortization deductions with respect to such facility computed in the manner provided in section 124 (a) but on the basis of the new amortization period.

§ 29.125-2 Determination of contract price—(b) Amortization period. A contractor which has elected to amortize taken under § 29.125-2 shall be disregarded and there shall be substituted, in lieu of the original 60-month period, a new amortization period beginning with the first month of the original 60-month period and ending with the period in which occurs the date the emergency use ceases. The contractor’s taxes for all taxable years (beginning with the taxable year in which the original 60-month period began) shall be computed (or recomputed) so as to give effect to amortization deductions with respect to such facility computed in the manner provided in section 124 (a) but on the basis of the new amortization period.
with respect to such facility computed in the manner provided in section 124 (a) (see § 29.124-2) but on the basis of an amortization period beginning with the month following the month in which such facility was completed or acquired, and ending with the last day of the month in which occurs the date of the emergency use cases.

Example. On September 25, 1942, the Z Corporation, which makes its income tax returns on the basis of the taxable year beginning the month of September, installed an emergency facility which it was entitled to amortize deductions with respect to such facility. The Secretary of the Navy certifies to the Commissioner that such facility was completed, as of July 20, 1944, to be necessary in the interest of national defense. The Z Corporation may elect, in the manner provided in paragraph (e) of this section, to take amortization deductions with respect to such facility and in such fashion, for the taxable years 1942, 1943, and 1944 to be computed or recomputed so as to give effect to amortization deductions computed in the manner prescribed in paragraph (b) of this section on the basis of an amortization period of 22 months (3 months in 1942, 12 months in 1943, and 7 months in 1944) and the adjustments of such amortization deductions to be in lieu of depreciation deductions previously taken during such 22-month period.

(2) Special rule with respect to incomplete facilities. If the date the emergency use cases occurs after the beginning of the construction, reconstruction, erection, or installation of an emergency facility or such section 124 (a) (2) (i) is to be applied to the computation of such facility, amortization to be based on a period beginning with the month in which the construction, reconstruction, erection, or installation of such facility was begun and ending as of the end of the month in which occurs the date the emergency use cases.

(e) Manner of making election. The election described in paragraph (b), (c), or (d) of this section shall be made by filing with the Commissioner of Internal Revenue, Washington, D.C., a statement of such election. Such statement shall be filed within 30 days after the date of the President's proclamation or the date of the certificate of the Secretary of the department concerned, whichever is the date of the taxpayer's election, and should contain a description clearly identifying the facility. A copy of such statement should be attached by the taxpayer to the income-tax return for the taxable year in which falls the date the emergency use cases.

(1) Recomputation of taxes in case of omitted amortization period. The recomputation of the tax liability authorized by section 124 (d) (5) applies to any income or excess-profits tax imposed under chapter 1 or subchapter A, B, D, or E of chapter 2, to the capital stock tax imposed by chapter 6, and to any other tax. No adjustment directly or indirectly by the recomputation of the amortization deduction.

Under section 124 (d) (5) if the adjustment of any income or excess-profits tax for any taxable year to give effect to the revised amortization deduction is prevented (1) on the date of the certificate of the Secretary of the department concerned, or (2) within one year after such date, by any provision of law (other than section 3761, relating to compromises, and other than section 124 (d) (5) or by any rule of law, including the doctrine of res judicata, an adjustment shall nevertheless be made if a claim for refund or credit is filed or a notice of deficiency is mailed, as the case may be, within one year after the date of such certificate or proclamation. Section 124 (d) (5) applies only if, at the time of the filing of the claim for refund or a notice of deficiency, adjustment of the tax liability is permissible without recourse to such section.

The amount of any adjustment authorized by section 124 (d) (5) is limited to the increase in tax, as defined in the tax as recomputed under section 124 (d) (5) expires on March 16, 1946.

Claims for refund, the corporation, which makes its income tax returns on the basis of the taxable year beginning the month of September, 1942, and during which its gross income erroneously omitted and elects to terminate the amortization period, and to amortize the adjusted basis of such facility over the shortened period of 40 months beginning September 1, 1945, and ending August 31, 1946.

In the same manner as a deficiency for erroneously omitting in any taxable year. The amount of the adjustment is authorized under section 124 (d) (5).

Any rule of law, other than section 3761, pertaining to compromises, and other than section 124, is limited to the adjusted basis of such facility for which the adjustment is authorized under section 124 (d) (5). The amount of the adjustment authorized by this section shall be made by filing with the Commissioner of Internal Revenue, Washington, D.C., a statement of such election, which shall be filed within 30 days after the date of the President's proclamation or the date of the certificate of the Secretary of the department concerned, whichever is the date of the taxpayer's election, and should contain a description clearly identifying the facility. A copy of such statement should be attached by the taxpayer to the income-tax return for the taxable year in which falls the date the emergency use cases.

Excess-profits net income as recomputed

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
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<tbody>
<tr>
<td>Excess-profits credit</td>
<td>$51,000.00</td>
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<tr>
<td>Specific exemption</td>
<td>5,000.00</td>
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<tr>
<td>Total</td>
<td>$56,000.00</td>
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Excess-profits net income as recomputed

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excess-profits</td>
<td>$51,000.00</td>
</tr>
<tr>
<td>Specific exemption</td>
<td>5,000.00</td>
</tr>
<tr>
<td>Total</td>
<td>$56,000.00</td>
</tr>
</tbody>
</table>

Adjusted excess-profits net income

<table>
<thead>
<tr>
<th>Description</th>
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<tr>
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<td>Tax previously determined and paid</td>
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Amount of adjustment under section 124 (d) (5) to be refunded or credited

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excess-profits</td>
<td>$51,000.00</td>
</tr>
<tr>
<td>Specific exemption</td>
<td>5,000.00</td>
</tr>
<tr>
<td>Total</td>
<td>$56,000.00</td>
</tr>
</tbody>
</table>

Less: Additional deduction for amortization

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insurred property</td>
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<tr>
<td>Specific exemption</td>
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<td>Total</td>
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</table>

Amount of adjustment under section 124 (d) (5) to be refunded or credited

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excess-profits</td>
<td>$51,000.00</td>
</tr>
<tr>
<td>Specific exemption</td>
<td>5,000.00</td>
</tr>
<tr>
<td>Total</td>
<td>$56,000.00</td>
</tr>
</tbody>
</table>
INCOME TAX

Net income upon which tax previously determined was based... $763,000.00
Less: Additional deduction for amortization...
Amount deductible... $25,000.00
Amount deducted in return... 20,000.00
Balance... 5,000.00

Add: Adjustment for excess profits tax: Amount previously deducted... $4,200.00
As recomputed... 2,450.00
Balance... 1,750.00

Net income as recomputed... 70,550.00
Less: Dividends received credit... 8,600.00

Corporation surtax net income... 62,050.00
Less: Interest on obligations of the United States and its instrumentalities... None

Normal tax net income... 62,050.00
Surplus $25,000... 91,600.00
Surplus on 5%... 2,590.50
Normal tax on $62,050... 14,892.00
Income tax as recomputed... 18,982.50
Income tax previously determined... 19,993.00

Amount of adjustment under section 124 (d) (9) to be refunded or credited... 1,007.50

By reason of the limitations imposed by section 124 (d) (9), the adjustment is limited to the tax previously determined which results solely from the revision of the amortization deductions and the consequences flowing therefrom. Accordingly, the recomputation does not take into consideration the item of $25,000, representing interest received, which was omitted from gross income, or the item of $2,450, representing insurance expense, for which no deduction was allowed.

Since the claims for refund for the taxable years 1943, 1944, and 1945 were filed within the period of limitations provided in section 62, the provisions of section 124 (d) (5) are not applicable and any complete adjustment from the taxes for such taxable years may be made without regard to the limitations contained in section 124 (d) (9).

§ 29.124-6 Adjusted basis of emergency facility. (a) In general. The adjusted basis of an emergency facility for purposes of computing the amortization deduction may differ from what would otherwise constitute the adjusted basis of such emergency facility, in that it shall be the adjusted basis for determining gain (see section 113) and in that it may be only a portion of what would otherwise constitute the adjusted basis.
If the adjusted basis of such other adjusted basis if only a portion of the basis (unadjusted) is attributable to the certified construction, reconstruction, erection, installation, or acquisition after December 31, 1939, it is therefore necessary to determine the unadjusted basis of the emergency facility from which the adjusted basis for amortization purposes is derived.

The unadjusted basis for amortization purposes, in cases where the entire construction, reconstruction, erection, installation, or acquisition takes place after December 31, 1939, and such construction, reconstruction, erection, installation, or acquisition is certified in its entirety by the Secretary of the department concerned as necessary in the interest of national defense during the emergency period, is the same as the unadjusted basis otherwise determined.

In cases where the Secretary of the department concerned certifies the entire construction, reconstruction, erection, installation, or acquisition after December 31, 1939, as necessary in the interest of national defense during the emergency period, but only a portion of the construction, reconstruction, erection, installation, or acquisition attributable to the facility takes place after December 31, 1939, the unadjusted basis for the purposes of amortization is so much of the entire unadjusted basis as is attributable to the portion of the construction, reconstruction, erection, installation, or acquisition which has taken place after December 31, 1939.

The unadjusted basis of an emergency facility for amortization purposes is the unadjusted basis for amortization purposes less the adjustments properly taken to account which increase the adjusted basis.

Where a corporation begins the construction, reconstruction, erection, installation, or acquisition of a facility November 15, 1939, and such facility is completed on April 1, 1940, at a cost of $500,000, of which $400,000 is attributable to construction after December 31, 1939, the certificate of necessity covers the entire construction after December 31, 1939, and the unadjusted basis of the emergency facility for amortization purposes is therefore $300,000. For the period of limitation assigned to the remaining portion of the cost ($200,000), see § 29.124-7.

If the Secretary of the department concerned certifies a part of the construction, reconstruction, erection, installation, or acquisition after December 31, 1939, then the unadjusted basis for amortization purposes is limited to the amount attributable to such portion of the construction, reconstruction, erection, installation, or acquisition which has taken place after December 31, 1939. Assuming the same facts as in the example in the preceding paragraph, if the certificate is to the effect that only 50 percent of the construction after December 31, 1939, is necessary in the interest of national defense during the emergency period, the unadjusted basis for amortization purposes is 50 percent of $300,000, or $150,000.

Where a corporation begins the construction, reconstruction, erection, installation, or acquisition of a facility before June 11, 1940, and completes it after June 10, 1940, the part of such construction, reconstruction, erection, installation, or acquisition taking place after June 10, 1940, and the part thereof taken place after June 11, 1940, each constitutes a separate emergency facility, provided a certificate of necessity under section 124 (f) has been made with respect to each such part (see section 124 (e) and § 29.124-12).

FURTHER TAX EFFECTS OF AMORTIZATION

Furthermore, the part of such construction, reconstruction, erection, or installation taking place after December 31, 1939, and before June 11, 1940, is to have been completed on June 10, 1940 (see section 124 (e) (1) and § 29.124-21). Accordingly, under such circumstances, in applying the foregoing rules for determining the unadjusted basis of the emergency facility representing the part of the construction, reconstruction, erection, or installation taking place after June 10, 1940, the date "June 10, 1940" should be substituted for the date "December 31, 1939."

The adjusted basis of an emergency facility for amortization purposes is the unadjusted basis for amortization purposes.

The adjusted basis of an emergency facility for amortization purposes is the unadjusted basis for amortization purposes.

Example 1 (f) The X Corporation completes an emergency facility on July 1, 1940, the entire unadjusted basis of which is $300,000, and the unadjusted basis of which, for purposes of amortization is $250,000. The X Corporation integrates to begin amortization on July 1, 1941. The only adjustment to basis for the period from July 1, 1940, to January 31, 1941, other than depreciation or amortization for January 1941, is $5,000 for depreciation for the last six months of 1940. The adjusted basis for the purpose of amortization is therefore $200,000 less $5,000 ($200,000 less $250,000) for the six months of 1940.

Example 2 (g) On July 1, 1942, the Y Corporation begins the construction, reconstruction, erection, installation, or acquisition (building) completed on July 1, 1940, the entire unadjusted basis of which is $300,000, and the unadjusted basis of which, for purposes of amortization is $250,000. The corporation elects to begin amortization on January 1, 1941, by which time it is entitled to $5,000 depreciation for the last six months of 1942. The adjusted basis of the emergency facility as of July 1, 1942, for purposes of amortization and depreciation, and the unadjusted basis of its properties, are $233,693.18, $423,235.68, and $765,135, respectively, computed as follows:

<table>
<thead>
<tr>
<th>Item</th>
<th>Adjusted Basis</th>
<th>Unadjusted Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unadjusted basis</td>
<td></td>
<td>$250,000.00</td>
</tr>
<tr>
<td>Less depreciation to January 1, 1941</td>
<td>$50,000.00</td>
<td>$200,000.00</td>
</tr>
<tr>
<td>Adjusted basis January 1, 1941</td>
<td>$150,000.00</td>
<td>$200,000.00</td>
</tr>
<tr>
<td>Less amortization for 11 months</td>
<td>$12,250.00</td>
<td>$187,750.00</td>
</tr>
<tr>
<td>Less depreciation for 11 months</td>
<td>$12,250.00</td>
<td>$187,750.00</td>
</tr>
<tr>
<td>Adjusted basis at close of 7/1, 1942</td>
<td>$137,750.00</td>
<td>$187,750.00</td>
</tr>
<tr>
<td>Less loss less depreciation as explained below</td>
<td>$50,000.00</td>
<td></td>
</tr>
<tr>
<td>Adjusted basis after July 1, 1942</td>
<td>$87,750.00</td>
<td></td>
</tr>
</tbody>
</table>

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<tr>
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<td>Less loss less depreciation as explained below</td>
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<td></td>
</tr>
<tr>
<td>Adjusted basis after July 1, 1942</td>
<td>$87,750.00</td>
<td></td>
</tr>
</tbody>
</table>
The $600,000 fire loss is applied against the adjusted basis for purposes of amortization and the adjusted basis for purposes of depreciation in the proportion that each such adjusted basis bears to their sum, i.e., $69,470.5473/100ths of $600,000 or $69,470.53, against the amortization basis, and $134,749.18, against the depreciation basis.

(b) Capital additions. If, after the completion or acquisition of an emergency facility with respect to which a certificate of necessity has been made, further expenditures are made for construction, reconstruction, erection, installation, or acquisition attributable to such facility but not included in such certificate of necessity, such expenditures shall be treated as additional costs of the emergency facility for amortization purposes under such certificate. If such further expenditures are covered by a separate certificate of necessity made in accordance with the provisions of section 124 (f), they are treated as certified expenditures in connection with a new emergency facility, and, if proper election is made, will be taken into account in computing the adjusted basis of such new emergency facility for purposes of amortization.

Example. On March 1, 1942, the Secretary of the department concerned certifies as an emergency facility a heating plant proposed to be constructed by the Z Corporation. Such facility is completed on July 1, 1942. The Z Corporation purchases an emergency facility on August 10, 1943, before the installation in the plant of an additional boiler, which is not included in the certificate for the plant but is, prior to such installation, certifiable as necessary in the interest of national defense. For amortization purposes, the adjusted basis of the heating plant is determined without including the cost of the additional boiler. Such cost is taken into account in computing the adjusted basis of the emergency facility (the boiler), as to which the taxpayer has a separate election for amortization purposes and a separate amortization period.

§ 29.124-7 Depreciation of portion of emergency facility not subject to amortization. The rule set forth in section 124 (a) (see § 29.124-2), that an amortization deduction with respect to an emergency facility for any deduction which would otherwise be allowable with respect to such facility, is subject to the exception provided in section 124 (g). Under this exception, if the property constituting such facility is depreciable property under section 23 (i) and the regulations pertaining thereto, then the depreciation deduction provided by such section and regulations is allowable with respect to such facility for such month, and shall not in any case exceed the adjusted basis of such facility (see § 29.124-6), as of the end of such month (computed without regard to any amortization deduction for such month). The election referred to in this paragraph shall be made in the return for the taxable year in which the amount of such payment is includible in gross income.

If a taxpayer is recovering the adjusted basis of an emergency facility through depreciation rather than amortization (determined without regard to depreciation for such month), he may elect to take any amortization deduction with respect to such facility for such month, and shall not in any case exceed the adjusted basis of such facility (see § 29.124-6), as of the end of such month (computed without regard to any amortization deduction for such month). The election referred to in this subsection (d) of section 29.124-9 on the hand for any taxable year beginning after December 31, 1941.

(1) Interest wholly or partially taxable. In the case of a bond (other than a bond the interest on which is excludible from gross income), the amount of the amortizable bond premium for the taxable year shall be allowable as a deduction.

(2) Interest wholly tax-exempt. In the case of any bond the interest on which is excludible from gross income, no deduction shall be allowed for the amortizable bond premium for the taxable year.

(3) Adjustment of credit in case of interest. In the case of any bond the interest on which is excludible from gross income, and the amortizable bond premium, no deduction shall be allowed for the amortizable bond premium for the taxable year.
(For adjustment to basis on account of amortizable bond premium, see section 113 of this chapter.)

(1) Partially tax-exempt bond premium—(a) Amount of bond premium. For the purposes of paragraph (2), the amount of bond premium which the holder of such bond is liable to include in the inventory of the taxpayer if on hand at the close of the taxable year, or any such obligation held by the taxpayer primarily for sale in the ordinary course of his trade or business.

§ 29.125-1 In general.—(a) Application. Section 125 makes provision for the amortization of bond premium by the owners of the bonds. It is mandatory with respect to such bonds only defined in section 25.

(1) Fully tax-exempt bonds (the interest on which is excludable from gross income), whether the owner is a corporation, individual, or other taxpayer; and

(2) Partially tax-exempt bonds (the interest on which is subject to tax by the application of the following classes of tax, see section 25). The election authorized under subsection (a) may be made in accordance with such regulations as the Commissioner will prescribe.

(a) Election on taxable and partially taxable bonds.—(1) Eligibility to elect and bonds with respect to which election permitted. This section applies with respect to the following classes of taxpayers with respect to the following classes of bonds only if the taxpayer so elects to have section 125 apply:—

(A) In the case of a corporation, bonds with respect to which the interest constitutes the basis of an ascertainable gain or loss, the basis of which was established prior to the date of which subsection (a) becomes applicable, with respect to:—

(1) Fully taxable bonds, and (2) partially taxable bonds.

(B) In all other cases, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury.

(b) Manner and effect of election. The election authorized under this subsection shall be made in accordance with such regulations as the Commissioner with the approval of the Secretary shall prescribe. If such election is made, the amount of the bond premium is the excess of the amount of the basis of the bond on the date of the elec- tion over the amount of the basis of the bond as of the date of the election. The election authorized under subsection (a) may be made in accordance with such regulations as the Commissioner will prescribe.

(c) Election in the case of a fully taxable bond to which section 125 is applicable. The election authorized under subsection (a) may be made in accordance with such regulations as the Commissioner will prescribe.

(d) Election in the case of a partially taxable bond to which section 125 is applicable. The election authorized under subsection (a) may be made in accordance with such regulations as the Commissioner will prescribe.

(e) Election to have section 125 applicable to the interest on which the bond premium is allocable with respect to the following classes of taxpayers with respect to the following classes of bonds only if the taxpayer so elects to have section 125 apply:—

(A) In the case of a corporation, bonds with respect to which the interest constitutes the basis of an ascertainable gain or loss, the basis of which was established prior to the date of which subsection (a) becomes applicable, with respect to:—

(1) Fully taxable bonds, and (2) partially taxable bonds.

(B) In all other cases, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury.

(f) Manner and effect of election. The election authorized under this subsection shall be made in accordance with such regulations as the Commissioner will prescribe.

(g) Election in the case of a fully taxable bond to which section 125 is applicable. The election authorized under subsection (a) may be made in accordance with such regulations as the Commissioner will prescribe.

(h) Election in the case of a partially taxable bond to which section 125 is applicable. The election authorized under subsection (a) may be made in accordance with such regulations as the Commissioner will prescribe.

(i) Election to have section 125 applicable to the interest on which the bond premium is allocable with respect to the following classes of taxpayers with respect to the following classes of bonds only if the taxpayer so elects to have section 125 apply:—

(A) In the case of a corporation, bonds with respect to which the interest constitutes the basis of an ascertainable gain or loss, the basis of which was established prior to the date of which subsection (a) becomes applicable, with respect to:—

(1) Fully taxable bonds, and (2) partially taxable bonds.

(B) In all other cases, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury.

(j) Manner and effect of election. The election authorized under this subsection shall be made in accordance with such regulations as the Commissioner will prescribe.

(k) Election in the case of a fully taxable bond to which section 125 is applicable. The election authorized under subsection (a) may be made in accordance with such regulations as the Commissioner will prescribe.

(l) Election in the case of a partially taxable bond to which section 125 is applicable. The election authorized under subsection (a) may be made in accordance with such regulations as the Commissioner will prescribe.

(m) Election to have section 125 applicable to the interest on which the bond premium is allocable with respect to the following classes of taxpayers with respect to the following classes of bonds only if the taxpayer so elects to have section 125 apply:—

(A) In the case of a corporation, bonds with respect to which the interest constitutes the basis of an ascertainable gain or loss, the basis of which was established prior to the date of which subsection (a) becomes applicable, with respect to:—

(1) Fully taxable bonds, and (2) partially taxable bonds.

(B) In all other cases, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury.

(n) Manner and effect of election. The election authorized under this subsection shall be made in accordance with such regulations as the Commissioner will prescribe.

(o) Election in the case of a fully taxable bond to which section 125 is applicable. The election authorized under subsection (a) may be made in accordance with such regulations as the Commissioner will prescribe.

(p) Election in the case of a partially taxable bond to which section 125 is applicable. The election authorized under subsection (a) may be made in accordance with such regulations as the Commissioner will prescribe.

(q) Election to have section 125 applicable to the interest on which the bond premium is allocable with respect to the following classes of taxpayers with respect to the following classes of bonds only if the taxpayer so elects to have section 125 apply:—

(A) In the case of a corporation, bonds with respect to which the interest constitutes the basis of an ascertainable gain or loss, the basis of which was established prior to the date of which subsection (a) becomes applicable, with respect to:—

(1) Fully taxable bonds, and (2) partially taxable bonds.

(B) In all other cases, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury.

(r) Manner and effect of election. The election authorized under this subsection shall be made in accordance with such regulations as the Commissioner will prescribe.

(s) Election in the case of a fully taxable bond to which section 125 is applicable. The election authorized under subsection (a) may be made in accordance with such regulations as the Commissioner will prescribe.

(t) Election in the case of a partially taxable bond to which section 125 is applicable. The election authorized under subsection (a) may be made in accordance with such regulations as the Commissioner will prescribe.

(u) Election to have section 125 applicable to the interest on which the bond premium is allocable with respect to the following classes of taxpayers with respect to the following classes of bonds only if the taxpayer so elects to have section 125 apply:—

(A) In the case of a corporation, bonds with respect to which the interest constitutes the basis of an ascertainable gain or loss, the basis of which was established prior to the date of which subsection (a) becomes applicable, with respect to:—

(1) Fully taxable bonds, and (2) partially taxable bonds.

(B) In all other cases, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury.

(v) Manner and effect of election. The election authorized under this subsection shall be made in accordance with such regulations as the Commissioner will prescribe.

(w) Election in the case of a fully taxable bond to which section 125 is applicable. The election authorized under subsection (a) may be made in accordance with such regulations as the Commissioner will prescribe.

(x) Election in the case of a partially taxable bond to which section 125 is applicable. The election authorized under subsection (a) may be made in accordance with such regulations as the Commissioner will prescribe.

(y) Election to have section 125 applicable to the interest on which the bond premium is allocable with respect to the following classes of taxpayers with respect to the following classes of bonds only if the taxpayer so elects to have section 125 apply:—

(A) In the case of a corporation, bonds with respect to which the interest constitutes the basis of an ascertainable gain or loss, the basis of which was established prior to the date of which subsection (a) becomes applicable, with respect to:—

(1) Fully taxable bonds, and (2) partially taxable bonds.

(B) In all other cases, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury.

(z) Manner and effect of election. The election authorized under this subsection shall be made in accordance with such regulations as the Commissioner will prescribe.
the bond at the time of the gift, and under section 117 (b) (2) X's holding period is deemed to include the 10 years during which his father held the taxable-exempt bond, but X is required to treat the bond as if the bond premium thereon had been amortized during his father's holding period. Thus, X is required to amortize $10 over the period 1942-1952 and in the year of redemption will have a capital gain or redemption attributable to his father's holding period.

Example (3). On January 1, 1945, Y, who makes his income tax returns on the calendar year basis, owns a tax-exempt $100 bond, maturing on January 1, 1951. He purchased this bond on January 1, 1941, for $110. On December 31, 1944, Y sells the bond for $110 and thus realizes a gain of $1, computed as follows:

1. Total bond premium ($110 minus $100) = $10
2. Amounts of bond premium amortization under section 125 (total bond premium minus bond premium attributable to 1941, $10 minus $1) = $9
3. (Amounts of bond premium amortized from January 1, 1942, through December 31, 1944 ($10 for each such year) = $10
4. Adjusted gain at close of 1944 ($110 minus $3) = $107
5. Gain ($108 minus $107) = $1

Amortizable bond premium on any bond to which section 125 applies is such part of the bond premium on the bond as is attributable to the taxable year.

§ 29.125-3 Methods of amortization. The determinations of the bond premium and amortizable bond premium on any bond to which section 125 applies shall be made in accordance with:

(a) The method of amortization regularly employed by the taxpayer, if such method is reasonable;
or
(b) The method of amortization prescribed by this section.

A method of amortization will be deemed "regularly employed" by a taxpayer if the method was consistently followed in taxable years beginning prior to January 1, 1942, or if for taxable years beginning prior to January 1, 1942, or if for taxable years beginning prior to January 1, 1942, the taxpayer regularly employed a reasonable method of amortization and consistently followed such method thereafter.

A taxpayer who regularly employs a method of amortization may be one, for example, who is subject to the jurisdiction of a State or Federal regulatory agency and who, for the purposes of such agency, amortizes the bond premium on his bonds in accordance with a method prescribed or approved by such agency. However, it is not necessary that the taxpayer be subject to the jurisdiction of such an agency or that the method be prescribed or approved by such agency. It is sufficient if the taxpayer regularly employs a method of amortization and if such method is reasonable.

The method of amortization prescribed by this section is as follows:

1. The bond premium on any bond to which section 125 applies shall be determined in accordance with § 29.125-2 and shall be computed as of the end of the taxable year (or as of the date of disposition or redemption of the bond, if it was disposed of or redeemed in the taxable year) but without regard to the amortizable bond premium for the taxable year.

2. The amortizable bond premium on such bond for the taxable year shall be an amount which bears the same ratio to the bond premium on the bond as the number of months in the taxable year during which the bond was owned by the taxpayer bears to the number of months from the beginning of the taxable year (or, if the bond was acquired in the taxable year, from the date of acquisition) to the date of maturity or earlier call date. For the purposes of this section a fractional part of a month shall be disregarded unless it amounts to more than half a month in which case it shall be considered as a month.

§ 29.125-4 Election. In the case of a corporation, the election provided in section 125 may be made only with respect to fully taxable bonds. In the case of a taxpayer other than a corporation, the election provided in such section may be made with respect to (a) fully taxable bonds only, or (b) partially tax-exempt bonds only, or (c) both fully taxable bonds and partially tax-exempt bonds.

Such election shall be made by the taxpayer by claiming a deduction for the bond premium in his return for the first taxable year to which the election applies. The election shall apply by the taxpayer at the beginning of the first taxable year for which the election is made and shall be deemed as of the earliest call date specified in the bond. If the election is so made, the taxpayer may, in each subsequent taxable year, treat as a deduction the amortizable bond premium for the purposes of section 125. The election shall be considered as a month.

The method of making such election is permitted. If the election is so made, the election may be revoked by the taxpayer at the beginning of the first taxable year to which the election applies in accordance with such section. The election to be applicable. No other election provided in such section may be made in accordance with such regulations to use the method of amortization prescribed by § 29.125-3, a taxpayer who regularly employs a reasonable method of amortization under which such capitalized expenses are amortized, may by election made owned by a partnership, common trust fund, or foreign personal holding company. The method of making such election is permitted. If the election is so made, the taxpayer may, in each subsequent taxable year, treat as a deduction the amortizable bond premium for the purposes of section 125. The election shall be considered as a month.

§ 29.125-5 Callable and convertible bonds. The fact that a bond is callable or convertible, or both, does not, in itself, prevent the application of section 125. For the purposes of such section, in the case of a convertible bond the earlier call date will be considered as the maturity date and the amount due on such date will be considered as the amount payable on maturity, unless the taxpayer regularly employs a different method of amortization which is reasonable. Hence, the bond premium on such bond is required to be spread over the period from the date as of which the basis for loss of the bond is established down to the maturity date. The earlier call date may be the earliest call date specified in the bond as a date certain, the earliest interest payment date if the bond is callable at such date, the earliest date at which the bond is callable at par, or such other call date, prior to maturity, specified in the bond as may be selected by the taxpayer.

The method of amortizing a bond premium with reference to a particular call date may not thereafter be made. The method of amortization prescribed by § 29.125-3, or if the taxpayer regularly employs a reasonable method of amortization under which such capitalized expenses are amortized, but not required, to amortize such capitalized expenses, may be required. If the election is so made, the taxpayer may, in each subsequent taxable year, treat as a deduction the amortizable bond premium for the purposes of section 125.
year is not required, but will be permitted in accordance with such method.

§ 29.125-3 Bonds owned by decedents—(a) Cash basis decedents. If a decedent on the cash receipts and disbursements basis owned fully taxable bonds or partially tax-exempt bonds to which section 125 applies:

(1) In the case of a fully taxable bond, the interest accruing thereon during the period ending with the date of the decedent's death, by reason of the amount received upon its receipt in the gross income of the estate or legatee, whichever acquires the right to receive such interest, while the deduction on account of amortizable bond premium for such period is properly allowable as a deduction for such period under the decedent's method of accounting and is not allowable as a deduction for the estate or legatee;

(2) In the case of a partially tax-exempt bond:

(i) The interest accruing thereon for such period is similarly included upon the decedent's return for the decedent as in this case

Example: At the time of his death in 1942, D owns a partially tax-exempt bond to which section 125 applies. For the period beginning January 1, 1942, and ending with his death, the accrued interest on such bond is $25 and the amortizable bond premium is $2. D's estate has the right to receive such interest. D's executor, in making the income tax return for such period, may take into account a deduction in the amount of $2 on account of the amortizable bond premium for such period. D's estate includes the interest in its gross income upon receipt and, for the purposes of the normal tax, receives a credit for $25, which is not reduced by the amount of the amortizable bond premium which was a deduction allowable for the last taxable period of the decedent.

(b) Accrual basis decedents. If a decedent on the accrual basis owns fully taxable bonds and partially tax-exempt bonds to which section 125 applies:

(1) In the case of a fully taxable bond, both the interest accruing thereon during the period ending with the decedent's death and the deduction on account of the amortizable bond premium for such period is allowable as a deduction in the return for the decedent and

(2) In the case of a partially tax-exempt bond, the rule as to the accrued interest and the amortization deduction is the same as in (1) above, and his credit for such interest is required to be reduced by the amount of the amortizable bond premium for the period ending with the decedent's death.

§ 29.125-9 Partially tax-exempt bonds owned by estates, trusts, partnerships, etc. If a trust owning partially tax-exempt bonds elects to amortize the bond premium thereon under section 125, the credits of the trust and the beneficiaries on account of such amortization deduction are required to be reduced by the portion of the amortization deduction attributable to their shares of such interest. A similar rule is applied in the case of partially tax-exempt bonds owned by estates, common trust funds, partnerships, foreign personal holding companies, and personal service corporations.


(a) Inclusion in gross income—(1) General rule. The amount of all items of gross income in respect of a decedent which are properly includible in respect of the taxable period in which falls the date of his death or a prior period shall be included in the gross income for the taxable period in which it fell.

(b) (A) The estate of the decedent, if the right to receive the amount is acquired by the decedent's estate, or

(B) The person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent;

(c) If the person who receives the amount from the decedent is not properly allowable to the decedent, the amount is included in the gross income of the person who receives the amount.

(d) Income in case of estate, etc. If a right, described in paragraph (1) to receive an amount, is transferred to another person before the date of the decedent's death or by bequest, devise, or inheritance from the decedent, the amount is transferred to the person who acquires from the decedent, and in the case of a transfer by reason of the death of the decedent, the amount is included in the gross income of the person to whom such transfer is made; or

(2) In case of estate, etc. If a right, described in paragraph (1), to receive an amount, is transferred to another person before the date of the decedent's death or by bequest, devise, or inheritance from the decedent, the amount is transferred to the person who acquires from the decedent, and in the case of a transfer by reason of the death of the decedent, the amount is included in the gross income of the person to whom such transfer is made; or

(3) In case of estate, etc. If a right, described in paragraph (1), to receive an amount, is transferred to another person before the date of the decedent's death or by bequest, devise, or inheritance from the decedent, the amount is transferred to the person who acquires from the decedent, and in the case of a transfer by reason of the death of the decedent, the amount is included in the gross income of the person to whom such transfer is made; or

(4) In case of estate, etc. If a right, described in paragraph (1), to receive an amount, is transferred to another person before the date of the decedent's death or by bequest, devise, or inheritance from the decedent, the amount is transferred to the person who acquires from the decedent, and in the case of a transfer by reason of the death of the decedent, the amount is included in the gross income of the person to whom such transfer is made; or

§ 29.125-1 Inclusion of gross income in respect of a decedent. The gross income for the taxable year of a decedent beginning on or after January 1, 1942, in which the decedent died, is computed upon the basis of the method of accounting followed by such decedent, even though amounts to which he is entitled as gross income are not included in his gross income or portions thereof in respect of which such person included the amount in gross income (or the amount included in gross income, whichever is lower), bears to the value for estate tax purposes of all the items described in subsection (a) as the value for estate tax purposes of the gross income or portions thereof in respect of which such person included the amount in gross income (or the amount included in gross income, whichever is lower).
of the partnership income computed on the basis of cash receipts and disbursements. Furthermore, if his partnership agreement had provided for the sale to the other partners upon his death of his right to receive his share of the surviving partners to his estate, the gain on such sale, accrued solely by reason of his death, would not be included in computing his net income.

Under section 126 (a) (1), all such amounts to which a decedent is entitled as gross income and which are not includible in computing his net income for his last taxable year or any prior taxable year shall be included, when received, in the gross income of the estate of the decedent or of the person receiving such amounts if such amounts were received in a taxable year ending after December 31, 1942, by the estate of the decedent or by a person entitled to such amounts by bequest, devise, or inheritance from the decedent.

The persons who are placed with respect to such amounts in the same position as the decedent are the decedent's surviving partner (for the purposes of the cash receipts and disbursements method of accounting) and was accrued only by reason of his death (for the purposes of the accrual method of accounting). If the payments are not payable to the surviving partner as coowner or beneficiary, and if the right to receive such payments is transferred to the children upon their majority, the children are within the meaning of the proviso to section 126 as receiving the right to such payments by reason of the death of the decedent, and must include such payments when received in their income to the extent the payments represent the gain on the sale.

Since section 126 provides for the treatment of such amounts as income to the estate or person entitled to such amounts by bequest, devise, or inheritance from the decedent or the person receiving it, for the purpose of determining the credit provided by section 25 (a) (1) and (2), as if such person had held the property from the sale, whichever is greater, is included in his gross income each of the three installments received by him.

Also placed in the same position as the decedent with respect to such amounts are those who acquire the right to such amounts by reason of the death of the decedent. An example of the application of this provision is the case of a decedent who owned a defense bond, with his wife as owner or beneficiary, and who died before the payment of such bond. The entire amount accruing on the bond and not includible in income by the decedent, not just that amount accruing after the death of the decedent, would be treated as income to his wife when the bond is paid. Another example is the case of a partner whose partnership agreement provided for a certain sum by the surviving partners in exchange for a payment of a certain sum by the surviving partners to his estate, the gain on such sale, accrued solely by reason of his death, would not be included in computing his net income.

The right to receive an amount of income in respect of a decedent is transferred by the estate or person entitled to such amount by bequest, devise, or inheritance, or by reason of the death of the decedent, the fair market value of such right at the date of the transfer shall be treated as income to the estate or of such person, plus the amount by which any consideration received on such transfer exceeds the fair market value of such right. Thus, upon a sale of property held for more than six months, the income from the sale, whichever is greater, is included in income. Similarly, if the right to receive the income is disposed of, as by gift or bequest, the fair market value of such right at the time of such disposition must be included in the gross income of the donor, testator, or other transferor. However, if the person to whom such right is transferred is a person including such amount in his gross income, section 126 (a) (1) as being entitled to such right by bequest, devise, or inheritance from the decedent or by reason of his death, is capital gain to the extent they exceed the adjusted basis of such assets in the hands of the decedent immediately prior to his death. This gain was not includible in the partner's income since it was not received by the partner (for the purposes of the cash receipts and disbursements method of accounting) and was accrued only by reason of his death (for the purposes of the accrual method of accounting). If the payments are not payable to the surviving partner as coowner or beneficiary, and if the right to receive such payments is transferred to the children upon their majority, the children are within the meaning of the proviso to section 126 as receiving the right to such payments by reason of the death of the decedent, and must include such payments when received in their income to the extent the payments represent the gain on the sale.

Since section 126 provides for the treatment of such amounts as income to the estate or person entitled to such amounts by bequest, devise, or inheritance from the decedent or the person receiving it, for the purpose of determining the credit provided by section 25 (a) (1) and (2), as if such person had held the property from the sale, whichever is greater, is included in his gross income each of the three installments received by him.

Each of the above examples must include the amount, when received, in his income, and if he transfers the right to receive such amount to a person not entitled to such right by bequest, devise, or inheritance from the decedent or by reason of his death, then he must include in his income the fair market value of the right at the time of such transfer.

The right to receive an amount of income in respect of a decedent shall be treated in the hands of the estate or the person entitled to receive such amount by bequest, devise, or inheritance from the decedent, as if it had been acquired in the transaction by which the decedent acquired such right, and shall be considered as having the same character it would have had if the decedent had lived and had made the sale. Similarly, if the income is interest on United States obligations owned by the decedent, such income shall be treated as income to the estate or the person receiving it, for the purpose of determining the credit provided by section 25 (a) (1) and (2), as if such person had held the property from the sale, whichever is greater, is included in his gross income.

Examples of such transfers are those by the estate to a specific legatee, devisee, or inherittee. Another example is the case of a partner whose partnership agreement provided for the sale to the surviving partners in exchange for payments to be made by them to his widow. Upon his death, the payments by the surviving partners must be included in the widow's income to the extent they exceed the adjusted basis of such assets in the hands of the decedent immediately prior to his death. This gain was not includible in the partner's income since it was not received by the partner (for the purposes of the cash receipts and disbursements method of accounting) and was accrued only by reason of his death (for the purposes of the accrual method of accounting). If the payments are not payable to the surviving partner as coowner or beneficiary, and if the right to receive such payments is transferred to the children upon their majority, the children are within the meaning of the proviso to section 126 as receiving the right to such payments by reason of the death of the decedent, and must include such payments when received in their income to the extent the payments represent the gain on the sale.

Since section 126 provides for the treatment of such amounts as income to the estate or person entitled to such amounts by bequest, devise, or inheritance from the decedent or the person receiving it, for the purpose of determining the credit provided by section 25 (a) (1) and (2), as if such person had held the property from the sale, whichever is greater, is included in his gross income each of the three installments received by him.
of the months included in the period in which the personal services were rendered. Similarly, the provisions of sections 105 and 106, relating to the tax attributable to the sale of certain oil or gas properties, are applicable against the United States, apply to any amount included in gross income, the right to which was obtained by the decedent by a sale or claim within the provisions of those sections. The tax attributable to the inclusion of this amount in the gross income of the person receiving it shall not exceed 30 percent of such amount.

§ 29.128-2 Allowance of deductions and credit in respect of decedent. Under section 126 (b), the expenses, interest, and taxes described in section 23 (a), (b), and (c) for which the decedent, dying in a taxable year beginning after December 31, 1942, was available, the tax was not properly allowable as a deduction in his last taxable year or any prior taxable year, are allowed when paid (a) as a deduction by the estate, or (b) if the estate is entitled to pay such obligation, as a deduction by the person who by bequest, devise, or inheritance from the decedent or by reason of the death of the decedent acquires subject to such obligation a property or interest of the decedent. Similar treatment is given to the foreign tax credit provided by section 31. For the purposes of (b) above, the right to receive an amount of gross income described in section 126 (b) is determined by first ascertaining the net value in the decedent's estate of the items which are included under section 126 in computing the income of the persons described in section 126 (b), and then subtracting from the gross estate the value of the included in the gross estate on account of the items of gross income in respect of the decedent over the deductions from the gross estate for such claims and such deductions and credits in respect of the decedent described in section 126 (b). The portion of the estate tax (the sum of the basic estate tax and estate tax reduced by the credits against such taxes) attributable to the inclusion in the gross estate of such net value is the excess of the estate tax over the estate tax computed with such net value in the gross estate. The estate and each person receiving income in respect of the decedent may deduct as his share of such portion of the estate tax an amount which has a net income bears to the value in the decedent's estate or person required to include in gross estate of all the items of gross income attributable to net value of income items.

§ 29.128-3 Deduction for estate tax attributable to income in respect of decedent. Section 126 (c) provides that the estate or person required to include in gross income any amount in respect of a decedent may deduct that portion of the estate tax on the decedent's estate which is attributable to the inclusion in the decedent's estate of the right to receive such amount. The deduction for depletion, computed on such number of units as if the person receiving such income had the same economic interest as the decedent, shall be allowed to such person regardless of whether or not he receives any interest in the mineral property other than such income. If the decedent did not compute his deduction for depletion on the basis of percentage depletion, any deduction for depletion for which the decedent was entitled at the date of his death would be allowable in computing his net income for his last taxable year, and there can be no deduction in respect of the decedent by any other person for such depletion.

§ 29.128-4 Income in respect of decedent dying in taxable year beginning before 1943; tax of decedent—(a) General. If the last taxable year of the decedent began before January 1, 1942, then under the law applicable to such taxable year before the enactment of the Revenue Act of 1942 all income in respect of such decedent was includible in his gross income for such taxable year, unless properly includible in gross income for prior taxable years. See §29.26-1. Section 124 (g) of the Revenue Act of 1942 gives the estate of the decedent and those persons entitled upon his death to receive amounts of income not includible in the income of the decedent under his method of accounting (but includible in his income under the provisions of section 42) the right to elect to have such amounts treated for tax purposes under the amendments made by the Revenue Act of 1942, that is, to exclude from the gross income of the decedent for his last taxable year any such amounts not included in the income of the decedent under his method of accounting, and to include such amounts when received in the gross income of the estate and of the other persons entitled to such amounts by bequest, devise, and inheritance by reason of the death of the decedent. The election to have these amounts treated in this manner is made by the filing of consents to such treatment by the fiduciary of the estate.
and by all such persons. Section 134 (g) of the Revenue Act of 1942 provides in part as follows:

(g) Taxable years before 1943. In case the taxable period in which falls the date of the death of the decedent in which falls the date of his death, December 31, 1933, and before January 1, 1943, the tax for such taxable period shall be computed as if provisions corresponding to the provisions of sections 275 (a) and 276 of the Internal Revenue Code, as amended by subsections (a) and (b) of this section, were a part of the Revenue Act of 1936, the Revenue Act of 1926, the Revenue Act of 1918, or the Internal Revenue Code, whichever is applicable to such taxable period. The tax of the decedent in which falls the date of his death shall be computed under such provisions for the taxable period in which falls the date of the decedent’s death or a prior period, and shall contain the following:

(a) The names and addresses of every person entitled by bequest, devise, or inheritance from such decedent to receive the amount of items of gross income, of the decedent which upon the application of the provisions of the section in effect for such taxable year would not be includible therein if the amendments made by section 134 (a) of the Revenue Act of 1942 were applicable to the revenue laws in effect for such taxable year. See § 29.43–1.

(b) Consents; tax of estate and persons filing consents. For the purposes of the election provided by section 134 (g) of the Revenue Act of 1942, the consents must be filed by the fiduciary of the estate and by each person who received any right to income from the estate of the decedent by bequest, devise, or inheritance from the decedent or by reason of the death of the decedent to receive any property subject to an obligation of the decedent for which a deduction of credit described in § 29.43–2 is allowable. Each consent shall be made under oath and shall contain the following:

(i) The names and addresses of the person filing the consent, and the collection district in which he files his return.

(ii) The name and address of the decedent, the date of his death, the period for which the consent is filed, and the collection district in which such return was filed.

(iii) A list of all the items (at face value) of income in respect of the decedent to which the person filing the consent was entitled by request, devise, or inheritance from the decedent or by reason of the death of the decedent. If the person filing the consent is the fiduciary, administrator, or other fiduciary of the estate (or if there is no such fiduciary, the principal beneficiary of the estate) such statement must contain, under oath, a statement accompanying the consents and containing the following information:

(1) A list of all the items included in the gross income of the estate for the last taxable year which would not be includible therein if the amendments made by section 134 (a) of the Revenue Act of 1942 were applicable to the revenue laws in effect for such taxable year. See § 29.42–1.

(2) The amount included in gross income with respect to each of such items, the aggregate of such amounts, the value included in the gross estate of the decedent for the last taxable year, which would not be allowable as deductions and credits in computing the net income of the decedent for his last taxable year, which would not be allowable as deductions and credits if the amendments made by section 134 (b) of the Revenue Act of 1942 were applicable to the revenue law in effect for such taxable year. See § 29.43–1.

(4) The amount allowable as a deduction or credit with respect to each item listed in (3), the aggregate of such amounts, the amount of the deductions for estate tax purposes from the gross estate of the decedent in respect of claim which are founded upon that portion of such items as are described in section 126 (b), and the aggregate of such deductions.

(5) The names and addresses of every person entitled by bequest, devise, or inheritance from the decedent or by reason of the death of the decedent to receive any amount listed in (1).

(6) The names and addresses of every person entitled by request, devise, or inheritance from the decedent or by reason of the death of the decedent to receive any property subject to an obligation of the decedent for which a deduction of credit described in § 29.43–2 is allowable.
clarity of the estate of the decedent, the list shall set forth every item (at face value) of each credit which was allowable, and each item (at face value) of each deduction which was allowable, and each item (at face value) of each item which was transferred by the decedent by bequest, devise, or inheritance.

If any item is transferred by bequest, devise, or inheritance, or by reason of the death of the decedent, then the list must show the amount of any increase in tax upon such recomputation which is attributable to each previous taxable year in which any item is included in the gross income of the decedent. See §§ 29.126-1, 29.126-2, and 29.126-3 by including in gross income the income in respect of the decedent which is includible under section 126 (a) and by allowing as deductions and credits the deductions and credits which are made applicable to such taxable year under section 126 (b) and (c) when section 126 is made applicable to such taxable year and when the amendments made by section 124 (a) and (b) of the Revenue Act of 1943 are made applicable to the law in effect for the last taxable year of the decedent (see §§ 29.42-1 and 29.43-1). This recomputation shall be made only for taxable years which do not terminate after the date the consent is filed. The increase or decrease in tax for each such taxable year as a result of such recomputation shall be shown, as well as the aggregate of such increases and the aggregate of such decreases.

(v) An unqualified statement by the person filing the consent agreeing that the tax for the last taxable year of the decedent which has been paid, the amount and date paid.

(vi) The consent shall set forth the limitations for assessing or collecting the increase in tax upon such recomputation which is attributable to each previous taxable year immediately after the filing of the consent, and such assessment and collection may be made whether or not any period of limitation or any rule of law would otherwise prevent such collection or assessment. Interest on the increase in tax for each previous taxable year in which such increase in tax is attributable to any such item and any credit or refund of such excess, and the period of limitation for filing such claim includes one year immediately after the filing of the consent, and may be made whether or not any period of limitation or any rule of law would otherwise prevent such credit or refund. The amount of such credit or refund will not exceed the amount of the tax paid for such taxable year.

The claim for credit or refund, prescribed by section 293 (b) (2), in cases in which the decedent had more deductions subject to the amendment made by section 134 (b) of the Revenue Act of 1942 than income subject to the amendment made by section 134 (a) of such Revenue Act, a deficiency for his last taxable year may result from the retrospective application of such amendments under section 134 (g) of such Act. Since the estate and the beneficiaries, in the filed consents, agree to the readetermination of the tax of the decedent for his last taxable year, such tax will be assessed and collected notwithstanding the prior running of any period of limitations or any other rule of law which would otherwise bar such assessment and collection.

Since the income tax of the decedent for his last taxable year was deductible as a claim against his estate in determining the estate tax, any overpayment of income tax for his last taxable year may have been an improper deduction from his gross estate. Therefore, if any such overpayment is determined for such taxable year by reason of the application of section 134 (g) of the Revenue Act of 1942, the estate tax must then be recomputed as if such overpayment of income tax, and upon this recomputation a deficiency in estate taxes may be determined. If at the time any credit or refund of such overpayment in income tax is allowed or made, the assessment and collection of the deficiency in estate taxes are barred by any provision of the internal revenue laws or by any other law which would otherwise be refunded or credited. Similarly, if there was a deficiency in income taxes determined for the decedent’s last taxable year, such deficiency in estate taxes is assessed, the assessment and collection of the deficiency in estate taxes are barred by any other law which would otherwise be refunded or credited. Similarly, if there was a deficiency in income taxes determined for the decedent’s last taxable year, such deficiency in estate taxes is assessed, the assessment and collection of the deficiency in estate taxes are barred by any other law which would otherwise be refunded or credited.

Sec. 127. War losses. (As added by sec. 165 (a), Rev. Act 1921.)

(a) Cases in which loss deemed sustained, and time deemed sustained. For purposes of this chapter—

(i) Property destroyed in enemy countries. Property destroyed or seized on or after December 7, 1941, in the course of military or naval operations by the United States or any other country engaged in the present war shall be deemed to have been destroyed or seized on a date chosen by the taxpayer in the manner provided in paragraph (4), which falls between—

(A) The latest date, as established to the satisfaction of the Commissioner, on which such property may be considered as not destroyed or seized, and

(B) The earliest date, as established to the satisfaction of the Commissioner, on which such property may be considered as having been destroyed or seized.

Sec. 128. Assessments, etc. (As added by § 322, Rev. Act 1921.)

(a) Assessments. Assessments shall be made as provided in section 322, and no assessment shall be made after June 1, 1943, and no assessment shall be made after June 1, 1943, and no assessment shall be made after June 1, 1943, and no assessment shall be made after June 1, 1943, and no assessment shall be made after June 1, 1943, and no assessment shall be made after June 1, 1943, and no assessment shall be made after June 1, 1943, and no assessment shall be made after June 1, 1943, and no assessment shall be made after June 1, 1943, and no assessment shall be made after June 1, 1943, and no assessment shall be made after June 1, 1943, and no assessment shall be made after June 1, 1943, and no assessment shall be made after June 1, 1943, and no assessment shall be made after June 1, 1943, and no assessment shall be made after June 1, 1943, and no assessment shall be made after June 1, 1943. If the claim for credit or refund is not filed within such period, the refund which may be made must not exceed the portion of the tax paid within the period, preceding the filing of the claim for credit or refund, prescribed by section 293 (b) (2).
For the purposes of this paragraph property within an area which comes under the control of a state or area that the United States after the date war with such country is declared by the United States shall be deemed to have been destroyed or seized in the course of military or naval operations by such country, and the date specified in subparagraph (A) shall not be later than the latest date of such control as the date on which such area was under the control of the United States or a country not at war with the United States as the date specified in subparagraph (B) shall not be later than the earliest date-determined by the Commissioner as the date on which such area may be considered under the control of the country which is at war with the United States.

(2) Property in enemy countries. Property within any country at war with the United States, or within an area under the control of any such country, and the property within any country at war with the United States as declared by the United States, shall be deemed to have been destroyed or seized on the date war with such country was declared by the United States.

(3) Investments referable to destroyed or seized property. Any interest in, or with respect to, para. or (2) (including any interest represented by a security as defined in section 23 (g) or (3) or section 21) in respect of such property, shall be considered as having been destroyed or seized (and the loss therefrom shall be considered as a loss of the destruction or seizure) on the date chosen by the taxpayer which falls between the dates specified in paragraph (1), or on the date prescribed in paragraph (2) as such may be, which the property or interest therein was last known to the taxpayer to have been destroyed or seized.

Under regulations prescribed by the Commissioner, on or after the date a state of war with the United States is declared by the United States, a taxpayer who owns 100 percent of the outstanding voting qualifying shares of each class of stock of a corporation may elect to determine the worthlessness of such property under the applicable paragraph, in or with respect to the property of the corporation, without regard to the amount of the property of such corporation which would be excluded under subsection (e) of this section, and such election shall be binding on the taxpayer in computing the income of the taxable year with respect to such property or investment. See § 23 (g) and (h) of this section.

§ 29.127 (a) Description of war losses. Under section 127, property is destroyed or seized in the course of the present war and property which is within an enemy country or an enemy controlled area on the date the United States declares the area or country at war with the enemy country result in war losses. Property which is within an area that comes under the control of an enemy country after the date the United States declares that a state of war exists with such enemy country also results in a war loss. An investment in any of the investments referred to in paragraph 1 is a loss for the purposes of this section only if the value of the property resulting from such property is itself treated as resulting in a war loss. Investments in such property which lose only part of their value by reason of the destruction or seizure resulting in a war loss are also treated under certain circumstances, as resulting in a war loss to the extent of such loss in value. See section 127 (e).

Section 127 (a) provides that the property and investments described above shall be treated as being "destroyed or seized" upon the date specified in the applicable subsections. That is, upon such date the taxpayer is treated as losing his entire interest in such property or investment, and this loss of such property rights is deemed to be ascertainable by reason of the destruction or seizure usually is the destruction or seizure, which ever event the taxpayer claims occurred. If the property or investment was held for more than six months and was a capital asset of the taxpayer as of the date or period of the destruction or seizure, the loss (and any compensation therefor) is subject to the provisions of section 121 (1), relating to gains and losses upon involuntary conversion of capital assets. See § 121 (j), relating to gains and losses upon involuntary conversion of capital assets. Thereafter, such a loss is treated under section 121 (j) as a loss from the sale or exchange of a capital asset, such loss is deductible as an ordinary loss under the provisions of section 23 (g) in the hands of the taxpayer, and section 23 (e) in the case of an individual. The loss upon an investment which is treated under section 127 as resulting in a war loss is not subject to the provisions of section 23 (g) and (k) (2) which treat losses upon worthless securities as capital losses, although such loss may nevertheless be treated under section 11 (l) and (m) of the Internal Revenue Code of 1954 as a loss of the sale or exchange of a capital asset.

For property to be treated as resulting in a war loss, such property must be in existence on the date prescribed in section 127 (a) (2) as a war loss. To claim the property as destroyed or seized under subsection (a) of this section, the property must actually be destroyed or seized in the course of military or naval operations of the United States, or be acquired by the United States in an area under the control of an enemy country after the date the United States declares that a state of war exists with such enemy country. This provision corresponds to the provisions of section 127 (c) (2) which give similar treatment to property located in an area under enemy control on the date the United States declares that a state of war exists with such enemy country, See § 127 (a) (3). The other purpose of section 127 (a) (1) is to provide the method for determining the date on which such destruction or seizure is deemed to have occurred. See § 127 (b) to (d). The exact date when control is established cannot be determined, and to provide the method for determining the date of destruction or seizure in the case of property which may be destroyed or seized in the course of military or naval operations by any country engaged in the present war if the exact date of such destruction or seizure cannot be established.

(a) Actual destruction or seizure. Any property actually destroyed or seized in the course of military or naval operations by the United States or any other country engaged in the present war shall be deemed to have been destroyed or seized on any date chosen by the taxpayer which falls between:

(1) The latest date, as established to the satisfaction of the Commissioner, on which such property may be considered as not destroyed or seized, and

(2) The earliest date, as established to the satisfaction of the Commissioner, on which such property may be considered as having already been destroyed or seized.

If the exact date of the destruction or seizure can be ascertained, then (1) refers to the day before such date and (2) refers to the day after such date. Thus, if the taxpayer knows that his property was destroyed during a bombing raid on London on January 7, 1943, the latest date on which such property may be considered as not destroyed or seized is January 6, 1943, and the earliest date on which it may be considered as being already destroyed is January 8, 1943. Under section 127 (a) (1), the only date the taxpayer may choose is January 7, 1943. However, in many cases the taxpayer will not be able to ascertain the exact date on which the destruction or seizure of his property occurred. In such cases the taxpayer may claim that the destruction or seizure occurred at any time he
chooses between the dates prescribed in (1) and (2) of this paragraph, which dates may be established on the basis of such information as the taxpayer is reasonably able to obtain. For example, the taxpayer's property was destroyed during a bombardment of a certain area which lasted several days. The taxpayer is only able to ascertain that the property was destroyed before the bombardment, and was already destroyed when the bombardment ended. The taxpayer may treat the destruction as occurring on any date during the bombardment.

Section 127 refers to a destruction or seizure by the United States or any other country engaged in the present war. Such other countries are the members of the United Nations, any belligerent in the war, any country not at war with the United States, and the enemies of the United States or any of the United Nations. Thus, a country which is not a member of the United Nations nor an enemy of the United States is not considered engaged in the present war if it is an enemy of any other member of the United Nations. Furthermore, the military operations may be carried on by the regular forces of the countries engaged in the present war, but it is sufficient if such operations are carried on by any forces supported by or operating in conjunction with any such country. For example, nationals of the D country form an independent fighting force for the liberation of their country, which was conquered by an enemy of the United States. Such fighting force operates in conjunction with the forces of one or more of the United Nations. The military or naval operations of such forces are considered for the purposes of section 127 as military or naval operations by the countries, engaged in the present war, with which such forces operate.

The term “military or naval operations” in section 127 (a) (1) is used in a broad sense to cover all actions incident to belligerent activities, whether in furtherance of or in opposition to such activities. It includes operations carrying out a national policy or rendering a position under threat of attack or other danger more secure or less desirable to the attacker. For example, when invasion of a certain area by the forces of an enemy is imminent, civilians in such area may be considered as having already been destroyed or seized.

(b) Property deemed destroyed or seized by reason of enemy control. Property in an area which, after the date the United States declares war with a country, comes under the control of such enemy country is deemed to have been seized or destroyed in the course of military or naval operations by such country. Such destruction or seizure is deemed to occur on any date chosen by the taxpayer which falls between the latest date, as determined by the Commissioner, on which the area was under the control of the United States or a country not at war with the United States, and the earliest date, as determined by the Commissioner, on which the area was under the control of the enemy country.

If during the period described in the above paragraph the property in such area was actually destroyed or seized in the course of military or naval operations by any country engaged in the present war, the taxpayer may choose the date on which the destruction or seizure occurred any date falling after whichever of the following dates is the earlier:

1. The latest date, as established to the satisfaction of the Commissioner, on which such property may be considered as not destroyed or seized; or
2. The earliest date as determined by the Commissioner as the date on which such property may be considered as having already been destroyed or seized.

And failing before whichever of the following dates is the earlier:

1. The earliest date, as established to the satisfaction of the Commissioner, on which such property may be considered as not destroyed or seized; or
2. The earliest date determined by the Commissioner as the date on which such property was under control of the United States or a country not at war with the United States.

Examples:

(a) Property not at war with the United States. The taxpayer has property in an area evacuated on December 20, 1942, under attack by the enemy, but the taxpayer who remained in the area ascertains that the property was not destroyed on that date, but was destroyed on January 1, 1943. An enemy country gained control of the area on February 1, 1943. The earliest date on which the taxpayer may claim the loss is December 20, 1942, the date on which the area was under control of a country not at war with the United States. The latest date on which it may claim the loss is January 1, 1943, the day before the earliest date on which the property may be considered as having already been destroyed. An additional example is the case of a taxpayer with property in an area evacuated on December 15, 1942, when a country not at war with the United States lost control of such area. The property of the taxpayer in such area was undestroyed on such date, and the United States was in control of the area on January 21, 1943. The taxpayer learns that on July 15, 1943, the property was destroyed in a bombing raid on such area. The loss may be claimed as occurring on any date later than January 20, 1943, the day before the earliest date on which the enemy country was in control of the area.

(b) Property destroyed or seized by reason of gain of control. Whether or not a country at war with the United States gains control over intangible property by reason of its gaining control over any area is determined under the same provisions as are applicable for the purposes of section 127 (a) (2) for the purposes of section 127 (a) (1). Such property is subject to the control of the enemy country on the date war is declared. See § 29.127-3.

In the case of any property which is within the provisions of section 127 (a) (1) by reason of any area falling under the control of an enemy of the United States, it is necessary to determine the latest date on which the United States was in control of such area, and the earliest date on which the United States was in control of such area and the ‘earliest date on which the country at war with the United States was in control of such area. For the purposes of section 127 (a) (1), control of an area on any day may mean effective control which is not seriously disputed at any time during such day. For such control to exist, order must be maintained in the area, such order must be maintained by authority of the country in control, and such order must not be seriously disputed by hostile action either by elements of the civilian population or by the armed forces of any country not at war with the United States.

Section 127 (a) (1) contemplates that in many cases there will be a lapse of time between the date when one country loses control of an area and the establishment of another country in control. During this period neither country will be in control of the area, and the loss may be claimed to occur at any time during such period. The fact that any earlier date cannot be determined is not sufficient for the purposes of section 127 (a) (1) unless a country at war with the United States gains control of such area. That is, if a country not at war with the United States, which has lost control of an area, regains control of the area before a country at war with the United States gains control, the fact that control was lost for a period of time does not cause any property in the area to be deemed to have been destroyed or seized.

It should be noted that the term “area” means the locality in which the property is situated. Thus, the question will be whether control by any country was lost or established in any area on any date will be made in a practical manner on the basis of all factors, and particular attention will be paid to the nature of the military and political operations affecting the control over such area as well as to the amount of information which can be obtained under the circumstances. For example, in view of the fact that the island of Luzon was one theater of military operations, complete control over such island by the American and Philippine forces was established in December 1941, upon the beginning of the Japanese invasion of the island, and complete Japanese control was not restored until May 1942, upon the cessation of American resistance at Corregidor. In the absence of information to the contrary, control by American and Philippine forces over other Philippine Islands will be considered to have ceased on the date in December 1941 when complete control of
Luzon ceased, and Japanese control over such other islands will be considered to have begun on the date in May 1942 when complete Japanese control of Luzon began. Similarly, control over areas in other theaters of military or political action will be determined on the basis of the principal events in such theaters of action.

A country at war with the United States may gain control over an area by its armed forces or civil authorities, or by obtaining control over the local authorities already established in that area. Such control over local authorities will not be deemed to exist by reason of the enemy country's domination over the government of any country if and so long as the United States maintains diplomatic relations with such government. Areas formerly subject to such government, or areas not in the hands of a government by virtue of its being an enemy of one of the United Nations.

The latest date on which the United States or a country not at war with the United States was in control of an area, and the earliest date when an enemy of the United States was in control of an area, are questions of fact to be determined by the taxpayer with respect to the destruction or seizure of property in such area, even though such country may be considered to have control over the areas in question by reason of its being an enemy of one of the United Nations.

The taxpayer must satisfy the Commissioner that such taxable year, or in a petition to which such date falls, in a claim for the destruction or seizure of property is the period described in paragraphs (a) or (b). The dates chosen are Droper.

The taxpayer must also attach to his request for permission to change the tax year in which the destruction or seizure may be treated as having occurred, a copy of his return, a claim for refund, or petition in which he makes such new choice to the Commissioner. If the taxpayer has once made the choice described above by the filing of a return, a claim, or a petition, the Commissioner shall not therefrom be considered as having made any change of date. For example, if the taxpayer on the calendar year basis desires to change his choice of date from a date in 1942 to one in 1943, and if there was a carry-back of losses or credits from 1942 to 1941, the taxpayer must attach to his request for permission to change his choice of date a recomputation of the tax for 1942, reflecting the effect of treating the destruction or seizure as occurring in 1943, for 1942, reflecting the effect of treating the destruction or seizure as not occurring in 1941, and a recomputation of the carry-back from 1942 determined by the Commissioner.

The taxpayer may make a new choice of date with the permission of the Commissioner shall send a copy of his request, claim for refund, or petition in which he makes such new choice to the Commissioner of Internal Revenue, Washington, D.C., together with a statement of the date chosen and a recomputation of each tax imposed by the Internal Revenue Code (including income, excess profits, and declared value excess profits taxes) for each taxable year treated by such change of date. For example, if the taxpayer on the calendar year basis desires to change his choice of date from a date in 1942 to one in 1943, and if there was a carry-back of losses or credits from 1942 to 1941, the taxpayer must attach to his request for permission to change his choice of date a recomputation of the tax for 1942, reflecting the effect of treating the destruction or seizure as occurring in that year, for 1942, reflecting the effect of treating the destruction or seizure as not occurring in that year, and an recomputation of the carry-back from 1942 determined by the Commissioner.

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over any area, may be exercised either through its military or civil agencies, or through its control over local authorities within the area, will be treated as being under the control of the enemy country if the enemy country exercises its control through the agents of a puppet government or through the local government of any area with respect to which the United States maintains diplomatic relations with such government. Areas formerly subject to such government but actually taken over by armed forces or civil authorities of the enemy country are under the control of the enemy country. Areas under the control of the governments of Hungary, Rumania, and Bulgaria will not be considered under enemy control prior to the date the United States declared that a state of war existed with such governments. Whether or not control by the enemy country exists is a question of fact to be determined by the Commissioner with such change may be made. The choice of a new date must be submitted in a return, claim for refund, or petition to the Tax Court of the United States or to the Commissioner.

The intangible property interest described in section 127 (a) (3) is deemed to be destroyed or seized upon the date that the last of the underlying assets latest date falls is due including any extension of time for filing such return), the taxpayer has not so chosen a date in a return, claim for refund, or petition, such latest date will be considered for credit or refund of an overpayment for such taxable year, or in a petition to The Tax Court of the United States with respect to such taxable year. In the case of a taxpayer requesting the Commissioner in order to choose a new date must submit the same information as is required under section 127 (c) (1) and (2) in the case of a taxpayer changing his choice of date under section 127 (a) (1), and such permission will be granted if the proper adjustments in tax liability resulting from such choice may be made. The choice of date by the taxpayer must be the same for all intangible property which relates to the same property treated as destroyed or seized under section 127 (a) (1) and (2). Thus, a taxpayer owning stock and bonds in a corporation, all the assets of which are in a country that comes under the control of the enemy, cannot under section 127 (a) (2) treat the stock as destroyed or seized on one date and the bonds as destroyed or seized on another date.
bonds as destroyed or seized on another date.

If a taxpayer owns 100 percent (excluding qualifying shares) of each class of stock of a corporation, it may elect for the purposes of section 127 (a) (3) to determine the worthlessness of its interest in such corporation and thereafter to the amount of the property of such corporation which is money in the United States, bank deposits, the right to receive the amounts of the property or interest, or of receiving any compensation (other than insurance or similar indemnity) on account of such property or interest in the taxable year or in any future taxable year.

(2) The taxpayer may choose to decrease the amount of the loss of obligations of the taxpayer with respect to such property or interest or satisfied the property or interest from the destruction or seizure, if the Commissioner is satisfied that such obligations or liabilities are so discharged or satisfied in a subsequent taxable year, or that the taxpayer is unable to determine whether or not such obligations or liabilities are in fact discharged or satisfied.

If a taxpayer has property in an area under the control of an enemy country on the date the taxpayer is deemed to have property or interest, or of receiving any such property or interest, shall be determined by the Commissioner for the entire interest of the taxpayer in the corporation, whether or not such property or interest shall be deemed a capital loss under the provisions of section 127 (a) (3), of any other loss by casualty (see §§ 127 (a) (2) and 127 (a) (3), the entire value of such property or interest, under section 127 (a) (2) treated as destroyed or seized under section 127 (a) (2).

If a taxpayer owning 100 percent of each class of stock of a corporation elects under section 127 (a) (3) to determine the worthlessness of its interest in such corporation without regard to certain assets of the corporation as described in section 127 (a) (5), the entire value of such property or interest, as of the date of the taxpayer’s interest in the corporation is deemed destroyed or seized under section 127 (a) (3) shall be treated as a recovery on such date by the taxpayer in determining the amount of his loss upon such destruction or seizure. Obligations of the corporation enforceable against such assets are deemed recovered in determining the amount of such recovery. For example, if the corporation’s interest in such assets is worth $100,000, the taxpayer’s recovery under the provisions of section 127 (a) (3) may be $100,000, regardless of whether or not any obligations of the corporation, enforceable against such assets, are superior to the interest of the taxpayer in the corporation. Thus, if the taxpayer’s interest in the corporation is his ownership of its stock, and if the adjusted basis of such stock is $1,000,000, his loss is $800,000 even though the taxpayer may have $300,000 in outstanding bonds enforceable against such assets of $100,000 and against its other assets which were not treated as destroyed or seized under section 127 (a) (3) were made.

If, in the same taxable year in which the destruction or seizure of any property is deemed to occur, such property was used to discharge or satisfy any obligations and liabilities of the taxpayer, or if any such obligations and liabilities are discharged by reason of the events which cause such property to be treated as destroyed or seized, the amount of such compensation must be taken into account in determining the loss upon the destruction or seizure of the property. Furthermore, the taxpayer may elect to, decrease the amount of his loss in the subsequent taxable year with respect to any property treated as destroyed or seized under section 127 by the amount of his other obligations and liabilities with respect to such property if such obligations or liabilities are discharged in a subsequent taxable year out of such property or if the taxpayer is unable to determine at the time of the election whether or not such obligations or liabilities are discharged. The determination of the amount of the loss where there are obligations and liabilities with respect to destroyed or seized property is illustrated by the case of a bank having a branch in Rumulus, the assets of which are treated under sec-
tion 127 (a) (2) as destroyed or seized on the date war is declared with Rumana. In determining the loss upon such assets, consideration must be given to the compensation for the destruction or seizure resulting from the assets being used in the same taxable year to discharge the bank's liabilities to depositors in the branch. Furthermore, if the bank establishes that any liabilities to depositors were discharged out of the assets in a subsequent taxable year, or if the bank establishes that any liabilities to depositors were discharged out of the assets in a subsequent taxable year, and if the bank establishes that it is unable to determine whether or not such liabilities were discharged out of the assets, it may elect to decrease the amount of the loss with respect to the assets in the branch by all such liabilities. If it is determined that any liabilities which were discharged out of the assets, the bank may not decrease the amount of the loss by the amount of such liabilities.

The election described above to decrease the amount of the loss by obligations and liabilities with respect to the destroyed or seized property is made by so decreasing the loss in claiming a deduction. The amount of the decrease of such return was filed on or before March 15, 1943, in an amendment thereto filed on or before July 1, 1943) in a claim for credit or refund of an overpayment, or in a petition to the Tax Court of the United States with respect to the taxable year in which the loss was sustained, and by attaching to such return (or such amendment thereto filed on or before July 1, 1943) a statement which shall be an amount equal to the aggregate of the assessable deductions in prior taxable years on account of the destruction or seizure of property described in subsection (a), such amount shall be considered a gain upon the involuntary conversion of property as a result of its destruction or seizure. To the extent that such amount plus the amount of any previous such recoveries exceed that part of the aggregate of such deductions which did not result from any tax of the taxpayer under this chapter and do not exceed that part of the aggregate of such deductions which did not result from any tax of the taxpayer under this chapter, such amount shall be included in gross income but shall not be deemed a gain upon the involuntary conversion of property as a result of its destruction or seizure. To the extent that such amount plus the aggregate of such deductions which did not result from any tax of the taxpayer under this chapter and exceed the aggregate of the allowable deductions in prior taxable years on account of the destruction or seizure of property described in subsection (a), such amount shall be considered a gain upon the involuntary conversion of property as a result of its destruction or seizure. To the extent that such amount plus the aggregate of such deductions which did not result from any tax of the taxpayer under this chapter and exceed the aggregate of the allowable deductions in prior taxable years on account of the destruction or seizure of property described in subsection (a), such amount shall be considered a gain upon the involuntary conversion of property as a result of its destruction or seizure. The election when once made may not be changed only with the permission of the Commissioner. The election must be changed only with the permission of the Commissioner of Internal Revenue, Washington, D.C. Should a recovery be included in gross income as ordinary income until such time as it is determined that it is not re-
exceed the amount of all previous recoveries in the same and prior taxable years.
(b) The amount of the recoveries for any day which is not excluded from gross income under (a) is included in gross income as ordinary income, and is not considered gain on an involuntary conversion of property as a result of its destruction or seizure. The following provisions then apply to this gain:
(1) Such gain is recognized or not recognized, unless under section 112 (f) relating to gain upon such conversion of property. For the purpose of applying section 112 (f) such gain for any day is deemed to be excluded in the manner provided in section 112 (f) to the extent the recovery for such day is so excluded.
(2) If such gain is recognized it is included in gross income as ordinary income. The aggregate of all the allowable deductions for prior taxable years on account of war losses, or $2,000, exceed $1,000, the sum of the $800 of previous recoveries and of the $200 portion of the recovery with respect to which is not included in gross income. On a later date the taxpayer sells for $2,000 his rights to recognize. Since the aggregate of all the allowable deductions for prior taxable years on account of war losses ($800) do not exceed the $200 portion of the recovery by the taxpayer ($800 and $1,000, or $2,000), note of the recovery on account of C is excluded from gross income. This recovery is included in gross income as ordinary income, and is not considered gain on the involuntary conversion of property, since it is less than the amount by which the aggregate of all the allowable deductions in prior taxable years on account of war losses, or $2,000, exceeds $1,000, the sum of the $800 of previous recoveries and of the $200 portion of the recovery with respect to which is not included in gross income. On a later date the taxpayer sells for $2,000 his rights to recognize. Since the aggregate of all the allowable deductions for prior taxable years on account of war losses ($800) exceed $2,000, the sum of the $800 of previous recoveries and of the $200 portion of the recovery on account of C which is not included in gross income, $3,800 of the recovery is considered gain on the involuntary conversion of property on account of its destruction or seizure, and is not recognized if forthwith expended in the manner provided in section 112 (f). Thus, it is not recognized if it is forthwith expended for the acquisition of property, relation to the service or use to C. On a later date the taxpayer recognizes over the aggregate of all the allowable deductions for prior taxable years on account of war losses ($800) or $2,000, all of the recovery with respect to D is considered gain on the involuntary conversion of property as a result of its destruction or seizure. Under the provisions of section 112 (f), this gain is not recognized if D is used for the same purposes for which it was used before it was deemed destroyed or seized under section 117. Example (2). The taxpayer on one day recovers $3,000 for property A and $7,000 for property B, both of which were treated under section 117 as destroyed or seized, in a prior taxable year, and $8,000 of such $10,000 recoveries is considered gain on the involuntary conversion of property as a result of its destruction or seizure. The amount of $10,000 was included in gross income under section 112 (f), leaving $3,000 of recognized gain. Property B is within the provisions of section 117 (d) relating to gains and losses on the involuntary conversion of certain described property, but property A is not. Therefore, the provisions of section 117 (d) apply to the recovery in respect to B which is considered gain on the involuntary conversion of property other than general property, and the amount of $3,000 is included in gross income. The recovery of property A is treated as a recognized gain from the involuntary conversion of property. Upon application of the tax, the aggregate of the gross income from the recognized gain would be subject to the provisions of section 117 (f).
(c) Section 112 (d) provides that if property recovered in respect of property considered destroyed or seized, under subsection (a) shall be determined under section 117 (d), the aggregate of all the property recovered in respect of any property treated as destroyed or seized under section 117, regardless of whether or not such deduction was claimed by the taxpayer for such recovery or other recovery of property, shall be an equal amount to the fair market value of such property, determined as of the date of the recovery, for the purpose of computing his tax. If a deduction was claimed by a taxpayer in computing his tax for any taxable year, and if such deduction was allowed, such deduction shall be considered an allowable deduction for such taxable year since the previous determination will not be reconsidered. [See 127, War Losses—amended by sec. 150, (a), Rev. Act 1943.]
(d) Basis of recovered property. The unadjusted basis of any property recovered in respect of property considered destroyed or seized, under subsection (a) shall be determined under section 117. Such basis shall be an equal amount to the fair market value of such property, determined as of the date of the recovery, for the purpose of computing his tax. If a deduction was claimed by a taxpayer in computing his tax for any taxable year, and if such deduction was allowed, such deduction shall be considered an allowable deduction for such taxable year since the previous determination will not be reconsidered.
\[sec. 127, War Losses—amended by sec. 150, (a), Rev. Act 1943.\]
\[d\] Basis of recovered property. The unadjusted basis of any property recovered in respect of property considered destroyed or seized, under subsection (a) shall be determined under section 117. Such basis shall be an equal amount to the fair market value of such property, determined as of the date of the recovery, for the purpose of computing his tax. If a deduction was claimed by a taxpayer in computing his tax for any taxable year, and if such deduction was allowed, such deduction shall be considered an allowable deduction for such taxable year since the previous determination will not be reconsidered.
all previous recoveries exceeds the aggregate of the allowable deductions for prior taxable years, or an account of war loss, so that a portion of the recoveries for such day is treated as gain on the involuntary conversion of property, such portion shall be treated as gain derived from the recovery of property described in section 127, and the adjusted basis of the property shall be increased by the amount of such gain, if any, for such day by the amount of such gain, if any, treated as gain described in section 127.

The amount of any adjustments to the adjusted basis of property under the first paragraph of this section shall, upon the allocation of the bases, be taken as an adjustment to the adjusted unadjusted basis. Thus, if $30 depreciation was allowed in any prior taxable year, the adjusted basis of the property immediately prior to the destruction, as determined under the first paragraph of this section, and if the unadjusted basis upon allocation of the property is $75, such $30 depreciation is allowed against such unadjusted basis. Thus, the adjusted basis of the property is then $45.

The taxpayer may choose any group of properties for allocation, except that any such recovered properties form a consolidated unit, such properties may not be separated but all or none must be included in the group. For example, a building may not be separated from the land on which it stands if both are recovered together, nor may one block of stock in a corporation be separated from other stock in such corporation or from bonds in such corporation which are also treated as a recovery. If the taxpayer is permitted to allocate the bases of any group of properties, he may obtain another allocation with respect to such properties only if all the properties in the original group are included together, with other recovered properties not included in the original group. For example, if the bases of properties A and B are allocated, a second allocation will be made for properties A, B, and C, but not for A and C or B and C.

[SEC. 127. WAR LOSSES—so added by sec. 156 (a), Rev. Act 1942.]

e. Application of section 127 (e) to the determination of certain investments in destroyed or seized property—(1) Destruction or seizure or investment. If a taxpayer owns not less than 50 per centum of each class of stock of a corporation, if such corporation has property described in subsection (a) (1) or (2), deemed to be destroyed or seized, and if the property is to be allocated, the assessment of an allocable part of the interest of the taxpayer in the property in the case of a corporation, there shall be deemed the known property of the corporation causes a war loss.

(b) Application of section 127 (e) to the determination of certain investments in destroyed or seized property—(2) Application of section 127 (e) to the determination of certain investments in destroyed or seized property.

(i) General rule. A taxpayer may choose any group of properties for allocation, except that any such recovered properties form a consolidated unit, such properties may not be separated but all or none must be included in the group. For example, a building may not be separated from the land on which it stands if both are recovered together, nor may one block of stock in a corporation be separated from other stock in such corporation or from bonds in such corporation which are also treated as a recovery. If the taxpayer is permitted to allocate the bases of any group of properties, he may obtain another allocation with respect to such properties only if all the properties in the original group are included together, with other recovered properties not included in the original group. For example, if the bases of properties A and B are allocated, a second allocation will be made for properties A, B, and C, but not for A and C or B and C.

(ii) Determination of adjustments. The amount of any adjustment to the adjusted basis of property under the first paragraph of this section shall, upon the allocation of the basis, be taken as an adjustment to the adjusted unadjusted basis. Thus, if $30 depreciation was allowed in any prior taxable year, the adjusted basis of the property immediately prior to the destruction, as determined under the first paragraph of this section, and if the unadjusted basis upon allocation of the property is $75, such $30 depreciation is allowed against such unadjusted basis. Thus, the adjusted basis of the property is then $45.

The taxpayer may choose any group of properties for allocation, except that any such recovered properties form a consolidated unit, such properties may not be separated but all or none must be included in the group. For example, a building may not be separated from the land on which it stands if both are recovered together, nor may one block of stock in a corporation be separated from other stock in such corporation or from bonds in such corporation which are also treated as a recovery. If the taxpayer is permitted to allocate the bases of any group of properties, he may obtain another allocation with respect to such properties only if all the properties in the original group are included together, with other recovered properties not included in the original group. For example, if the bases of properties A and B are allocated, a second allocation will be made for properties A, B, and C, but not for A and C or B and C.

(ii) Determination of adjustments. The amount of any adjustment to the adjusted basis of property under the first paragraph of this section shall, upon the allocation of the basis, be taken as an adjustment to the adjusted unadjusted basis. Thus, if $30 depreciation was allowed in any prior taxable year, the adjusted basis of the property immediately prior to the destruction, as determined under the first paragraph of this section, and if the unadjusted basis upon allocation of the property is $75, such $30 depreciation is allowed against such unadjusted basis. Thus, the adjusted basis of the property is then $45.

The taxpayer may choose any group of properties for allocation, except that any such recovered properties form a consolidated unit, such properties may not be separated but all or none must be included in the group. For example, a building may not be separated from the land on which it stands if both are recovered together, nor may one block of stock in a corporation be separated from other stock in such corporation or from bonds in such corporation which are also treated as a recovery. If the taxpayer is permitted to allocate the bases of any group of properties, he may obtain another allocation with respect to such properties only if all the properties in the original group are included together, with other recovered properties not included in the original group. For example, if the bases of properties A and B are allocated, a second allocation will be made for properties A, B, and C, but not for A and C or B and C.

The amount of any adjustment to the adjusted basis of property under the first paragraph of this section shall, upon the allocation of the basis, be taken as an adjustment to the adjusted unadjusted basis. Thus, if $30 depreciation was allowed in any prior taxable year, the adjusted basis of the property immediately prior to the destruction, as determined under the first paragraph of this section, and if the unadjusted basis upon allocation of the property is $75, such $30 depreciation is allowed against such unadjusted basis. Thus, the adjusted basis of the property is then $45.

The taxpayer may choose any group of properties for allocation, except that any such recovered properties form a consolidated unit, such properties may not be separated but all or none must be included in the group. For example, a building may not be separated from the land on which it stands if both are recovered together, nor may one block of stock in a corporation be separated from other stock in such corporation or from bonds in such corporation which are also treated as a recovery. If the taxpayer is permitted to allocate the bases of any group of properties, he may obtain another allocation with respect to such properties only if all the properties in the original group are included together, with other recovered properties not included in the original group. For example, if the bases of properties A and B are allocated, a second allocation will be made for properties A, B, and C, but not for A and C or B and C.
The corporation has completely liquidated within one year after the last date falling within six months after the enactment of the Revenue Act of 1942, the liquidation may be completed on or before that date. The corporation has completely liquidated if it has distributed its shares and other property to those who were entitled to receive the same, and has paid or set aside money to meet its liabilities, including money sufficient to pay the tax upon the liquidation as determined under section 117 (j), determining any appropriate authority.

The corporation has completely liquidated if it has distributed its property to its shareholders and has paid or set aside money to meet its liabilities, including money sufficient to pay the tax upon the liquidation as determined under section 117 (j), determining any appropriate authority.

In some cases the corporation may not be able to comply with certain formalities required by the applicable law. For example, a corporation chartered by a foreign country not at war may be required to hold its shareholders’ meetings in a foreign country, or to distribute its property in a foreign country, or to take other actions that are not possible under the applicable law.

In other cases, the validity of the liquidation will be determined on the basis of whether the corporation is in good faith has complied as fully as possible with all provisions of law applicable to such liquidation. The liquidation will not be considered invalid because of the absence of any formality incident to such liquidation with which the corporation was not able to comply, unless such liquidation is actually declared invalid by any appropriate authority. If a war loss upon such liquidation has been allowed, the Commissioner, if the taxpayer attached a statement to the return in which such loss was claimed, as a part thereof, to the effect that he had determined to consider the liquidation treated as a recovery for all purposes, including the treatment as a recovery by him for purposes of section 127 (c) of any recovery with respect to the assets and rights to assets distributed to him, if the taxpayer waived the benefits of any period of limitations which would prevent the adjustment of his tax liability on account of the invalidity of the liquidation at any time at which he should contend that the liquidation was invalid and the Commissioner should agree to permit him so to change his position, then (in the absence of such action with the permission of the Commissioner) the war loss will not be thereafter disallowed even though the liquidation may be declared invalid by some appropriate authority.

(b) Determination of amount of war loss. If the provisions of paragraph (a) of this section are met, the loss sustained by the taxpayer upon the liquidation described in this section is determined under section 127 (a) (1) or (2), determined for each such property as of the date immediately preceding the date it is deemed destroyed or seized, to the extent that such loss would be decreased (but not decreased below zero) if the corporation at the time of the liquidation owned additional assets, which it could distribute, having a fair market value equal to the amount of the taxpayer's total interest in that property as of the date immediately preceding the date it is deemed destroyed or seized. The amount of the war loss sustained by the taxpayer upon the liquidation described in section 127 (a) (1) or (2), determined for each such property as of the date immediately preceding the date it is deemed destroyed or seized, to the extent that such loss would be decreased (but not decreased below zero) if the corporation at the time of the liquidation owned additional assets, which it could distribute, having a fair market value equal to the amount of the taxpayer's total interest in that property as of the date immediately preceding the date it is deemed destroyed or seized, is not included in the aggregate of the adjusted bases for determining loss of all such property described in section 112, relating to the nonrecognition of gains and losses upon certain exchanges, but such provisions apply to that part of the loss which is not treated as a war loss. In determining the loss which is not treated as a war loss, no value shall be ascribed to the possibility of a recovery of the property of the corporation described in section 127, deemed destroyed or seized, the rights to which are distributed to him, or of compensation (other than insurance or similar indemnity) on account of its destruction or seizure. Any recovery in the taxable year with respect to such rights is taken into account under section 127 (b) in determining the amount deductible on account of the war loss.

The war loss described in this section is deemed to result from the destruction or seizure of the taxpayer's interest in the corporation to which it is allocable. Therefore, this war loss, in the amount determined under section 127 (b) (see § 29.127 (b)–1), is deductible as an ordinary loss by casually unless under section 117 (j), relating to losses on the involuntary conversion of certain property, it is treated as a loss on the sale or exchange of a capital asset. If part of the taxpayer's greater loss in the corporation is properly described in section 117 (j), and part is not, then for the purposes of section 117 (j) the war loss must be allocated to the various interests in the corporation. The portion
of any interest in the corporation to which any part of the war loss is allocable is deemed destroyed or seized under section 127 (e), and the part of the war loss allocated to such interest is deemed to result from such destruction or seizure. The aforesaid war loss to the stock and other interests of the taxpayer in the corporation is made as follows:

The war loss is apportioned among the stock and other interests of the taxpayer in the corporation in the manner in which the losses with respect to such interests, sustained upon the liquidation, would be decreased if the corporation had distributed, as described above for the determination of the amount of the war loss, assets equal in value to its property described in section 127 (a) (1) or (2). The war loss is allocable to that part of the stock or other interest of the taxpayer which is the same portion of such interest as the war loss apportioned to such interest is of the loss with respect to such interest sustained upon the liquidation.

For example, the taxpayer owns stock of class A and stock of class B in a corporation. Upon the liquidation described in paragraph (a) of this section it sustains a loss of $1,000 on the A stock and $2,000 on the B stock of a total loss of $3,000. If the corporation had distributed assets equal in value to its property described in section 127 (a) (1) or (2), the taxpayer would have received $1,000 with respect to A and $400 with respect to B, reducing his loss on each by such amounts. His $1,400 loss, $1,000 is apportioned to A and $400 to B. The war loss is allocable to all of the A stock ($2,000), and 40% of the B stock ($1,000 loss times A), and the $1,000 war loss apportioned to the A stock is deemed to result from its destruction or seizure. Similarly, the war loss is allocable to 20 percent of the B stock ($2,000 loss times B), and the $400 war loss apportioned to B is deemed to result from the destruction or seizure of a 20 percent interest in the B stock owned by the taxpayer.

SEC. 127. War losses—As added by sec. 158 (a), Rev. Act 1924.

(1) Determination of tax benefits. The determination as to whether and to what extent a deduction is allowed to account for the destruction or seizure of property described in subsection (a) did or did not result in a reduction of any tax of the taxpayer under this chapter shall be made in accordance with regulations prescribed by the Commissioner with the approval of the Secretary.

§ 29.127–1 Determination of tax benefits from allowable deductions. That part of the aggregate of the deductions allowed a taxpayer for any taxable year on account of war losses under section 127 which, if disallowed, would not result in an increase in the normal tax, surtax (including the tax imposed by section 102), or victory tax of the taxpayer, or of any tax imposed in lieu of such taxes, for the taxable year in which such deductions are allowed or in any other taxable year, such as a taxable year in which the taxpayer's-income tax is computed by reference to a carry-over or carry-back of net operating losses from the taxable year in which such deductions are allowed, is considered for the purposes of section 127 an allowable deduction for the taxable year which did not result in a reduction of any tax of the taxpayer under chapter 1 of the Internal Revenue Code. In determining that part of the aggregate of the deductions on account of war losses which, if disallowed, would not have resulted in an increase in any such income tax of the taxpayer, there shall first be excluded for each taxable year affected the deductions and credits on account of the hard debt, the net amount of any deduction which under section 23 (b) (12) and the regulations thereunder are treated as not resulting in a tax benefit. The deductions allowed a taxpayer for any taxable year on account of war losses are all the deductions on account of war losses which were claimed by the taxpayer in a return, in a claim for credit or refund of an overpayment, or in a petition to the Tax Court of the United States with respect to such taxable year and which were not disallowed, and all deductions on account of war losses which, although not so claimed by the taxpayer, were nevertheless allowed (for example, by the Commissioner, a court, or The Tax Court) in computing a tax of the taxpayer.

Any deduction allowable for a taxable year on account of a war loss under section 127 which was not claimed by the taxpayer for such year in a return, a claim for credit or refund of an overpayment, or a petition to the Tax Court of the United States and in a return to the Commissioner, a court, or The Tax Court in computing his tax for such year in a return, as a deduction for the purposes of section 127 (c) that such deduction was an allowable deduction for such taxable year. If the taxpayer claimed any deduction for any taxable year in a return or in a claim for credit or refund of an overpayment, the deduction may not be considered a deduction which did not result in a reduction of any tax of the taxpayer under chapter 1 of the Internal Revenue Code, since it is an allowable deduction which was not allowed in computing any tax of the taxpayer. If the taxpayer claimed any deduction for any taxable year in a return or in a claim for credit or refund of an overpayment, the deduction may not be considered a deduction which did not result in a reduction of any tax of the taxpayer under chapter 1 of the Internal Revenue Code, since it is an allowable deduction which was not allowed in computing any tax of the taxpayer. A deduction allowed for the prior taxable year or years with respect to which the statutory period for the assessment of a deficiency has expired may be opened only for the purpose of reducing the deduction allowed for the unconstitutional Federal tax and assessing the resulting deficiency or deficiencies, if any, and only if the taxpayer consents in writing to the assessment (see paragraph (b) of this section). No other adjustment will be allowed.

In the event the disallowance of the deduction allowed in respect of a prior taxable year results in a deficiency for that year, the deficiency will be assessed within the period agreed upon between the taxpayer and the Commissioner, in respect of the taxable year of the prior deduction, against the taxpayer who must file a written consent to the assessment as provided in paragraph (b) of this section even though the statutory period for the assessment may have expired prior to the filing of the consent. If a taxpayer does not elect under the provisions of section 123 to exclude the tax recovered from gross income in the taxable year of recovery, the tax recovered shall be held unconstitutional as unconstitutional under section 128 the income (exclusive of interest) attributable to such recovery from his gross income in the taxable year of recovery.

Where a taxpayer's liability for income tax with respect to the deduction or the recovery or with respect to the tax liability for the year of the deduction or recovery has been finally determined by a written agreement or by a decision of The Tax Court of the United States, any court, the taxpayer will not be entitled to the benefits of section 128 or of this section. As to taxability of refunds of taxes generally, see section 22 (b) (15).

Manner of making election. The election provided for in paragraph (a)
of this section shall be made by the taxpayer filing with the Commissioner a statement in writing that he elects to treat the deduction allowed in a prior taxable year for the unconstitutional tax as not having been allowable for such taxable year. Such election must be filed with the taxpayer's return for the taxable year in which the recovery of the unconstitutional tax or taxes occurs. Where the recovery antedates February 10, 1943 (the date of approval of Tax Court Decision 5226), the statement of election must be filed within 90 days after such approval date. No other method of making the election is permitted. The statement of election must contain a description of the tax recovered, the date of recovery, the taxable year in which paid or accrued and the taxable year in which the deduction was allowed. The statement of election must also contain a statement signifying the taxpayer's consent (1) to the Commissioner's treating the deduction or portion thereof in any subsequent taxable year with respect to the unconstitutional tax as not allowable for that year and (2) to the Commissioner's assessing, in respect of the taxable year for which the deduction was allowed, any deficiency tax charges against such deduction or portion thereof together with interest thereon as provided by law, resulting from disallowance of the deduction or portion thereof, even though the statutory period for the assessment of any such deficiency tax may have expired prior to the filing of such consent.

As used in this section the term "recovery" of any such refund credit of taxes previously paid, but includes also the cancellation of the purported tax liability which was accrued and deducted for a prior taxable year but never actually paid.

CREDITS AGAINST TAX

SEC. 131. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS AND OF DOMESTIC CORPORATIONS AND TRUSTS.

For the purposes of this section, a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be treated as a foreign corporation for the purposes of this section. The term "accumulated profits" when used in this subsection in reference to a foreign corporation, means the amount of any income, war-profits, and excess-profits taxes paid or deemed to be paid by such foreign corporation during any taxable year plus any amount of any income, war-profits, and excess-profits taxes paid or deemed to be paid by such foreign corporation during any taxable year by any foreign country or by any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation to the extent that such dividends were paid which the amount of such dividends-bears to the amount of such accumulated profits: Provided, That the amount of any excess-profits tax paid or deemed to be paid by such domestic corporation under this subsection shall in no case exceed the same proportion of the tax against which such credit is taken which the amount of such dividends bears to the amount of the normal-tax net income of (a) any domestic corporation or (b) any such foreign corporation.
whether resident or nonresident, and in the case of a domestic corporation, is as follows: (1) The amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year by or for any foreign country or to any possession of the United States; and (2) an individual's 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, and excess-profits taxes paid or accrued during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or a donee or the foreign country to which such alien resident is a beneficiary paid or accrued during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or a donee or the foreign country to which such alien resident is a beneficiary paid or accrued during the taxable year to any foreign country or to any possession of the United States, as the case may be.

In the case of an alien resident of the United States who chooses to claim a credit for such taxes the basis of the credit is as follows: (1) The amount of any such taxes paid or accrued during the taxable year to any possession of the United States; (2) the amount of any such taxes paid or accrued during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country, and (3) his proportionate share of any such taxes paid or accrued during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country.

If a taxpayer chooses to claim a credit for taxes, such action will be considered to apply to income, war-profits, and excess-profits taxes paid to all foreign countries and possessions of the United States, and no portion of any such taxes shall be allowed as a deduction from gross income.

There shall be available to the taxpayer with respect to claiming such credit may be exercised (or changed if previously exercised) by the taxpayer at any time prior to the expiration of the period prescribed by statute for the making of a claim for credit or refund for the taxable year. For disallowance as a deduction of foreign income, war-profits, or excess-profits taxes paid in the event such credits are not allowed under the provisions of section 119.

For taxable years beginning before January 1, 1943, no credit for taxes shall be allowed against the tax imposed under section 106, relating to surtax on corporations, on the amount of any accumulated surplus, and for taxable years beginning after December 31, 1942, credit for taxes shall be allowed neither against the tax imposed under section 106, relating to surtax on corporations, improperly accumulated surplus, nor against the victory tax imposed under section 450.

A citizen of the United States or a domestic corporation entitled to the benefits of section 251, or a China Trade Act corporation, is not allowed any of the credits provided by section 131.

§ 29.131-2 Meaning of terms. The term "amount of any income, war-profits, and excess-profits taxes paid or accrued 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 taxpayer claiming the credit.

§ 29.131-3 Conditions of allowance of credit. If the taxpayer does not signify in his return his desire to claim credit for income, war-profits, or excess-profits taxes paid other than to the United States, but subsequent to the filing of such return chooses to claim such credit, the taxpayer may notify the Commissioner and attach to such notification Form 1116 in the case of an individual, and Form 1119 in the case of a corporation. The form must be carefully filled in with all the data called for and with the calculations of credits there indicated, and must be duly signed and sworn to or affirmed. Except where it is established to the satisfaction of the Commissioner that it is impossible for the taxpayer to furnish such evidence, the form must have attached to it (1) the receipt for each such tax payment if credit is sought for taxes already paid or (2) the return showing which such accrued tax was based if credit is sought for taxes accrued. This receipt or return so attached must be either the original, a duplicate original, a duly certified or authenticated copy, or a sworn copy. In case only a sworn copy of a receipt or return is attached, there must be kept readily available for comparison on request the original, a duplicate original, or a duly certified or authenticated copy. If the receipt or return is in a foreign language, a certified translation thereof must be furnished by the taxpayer. (See also section 119 of the Revenue Act of 1926, as amended.)

§ 29.131-4 Redetermination of tax when credit proves incorrect. In case 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 tax.
pay for the year or years for which such incorrect credit was granted. The amount of tax, if any, due upon such re-determination shall be paid by the taxpayer upon notice and demand by the collector. The amount of tax, if any, shown by such re-determination to have been overpaid shall be credited or re-funded to the taxpayer in accordance with the provisions of section 322.

§ 29.131-5 Countries which do or do not satisfy the similar credit requirement. A country satisfies the similar credit requirement of section 131 (a) (3) as to income tax paid to such country, either by allowing to citizens of the United States residing in such country a credit for the amount of income taxes paid to the United States, or, in imposing such taxes, by exempting from taxation the incomes received from sources within the United States by citizens of the United States residing in such country. A country does not satisfy the similar credit requirement of section 131 (a) (3) if it does not allow any credit to citizens of the United States residing in such country for income taxes paid to the United States, or, if such country does not impose any income taxes. If the country of which a resident alien is a citizen or subject does not allow a United States citizen residing in such country a credit for taxes paid to such country, no credit is allowed to such resident alien for taxes paid by him to such other foreign country.

§ 29.131-6 When credit for taxes may be taken. The credit for taxes provided by section 131 (a) may ordinarily be taken either in the return for the year in which the taxes accrued or in the return for the year in which such taxes were paid, dependent upon whether the accounts of the taxpayer are kept and his returns filed upon the accrual basis or upon the cash receipts and disbursements basis. Section 131 (d) allows the taxpayer to take the credit for taxes paid under section 131 (d) or under section 222 (c) or 238 (c) of the Revenue Act of 1924 or 1926, or under section 131 (d) of the Revenue Acts of 1928, 1932, 1934, 1936, or 1938, must be allowed in returns for all subsequent years, and no portion of any such taxes will be allowed as a deduction from gross income. If, however, under the provisions of § 29.43-1 an amount otherwise constituting gross income for the taxable year from sources within the United States is, owing to monetary, exchange, or other restrictions upon the payment of foreign currency, not includible in gross income of the taxpayer for such year, the credit for income taxes imposed by such foreign country with respect to such amount shall be taxable in the United States in any subsequent taxable year in which such amount or portion thereof is includible in gross income.

§ 29.131-7 Taxes of subsidiary corporation—(a) Domestic corporation con-

such incorrect credit was granted. The amount of tax, if any, due upon such re-determination shall be paid by the taxpayer upon notice and demand by the collector. The amount of tax, if any, shown by such re-determination to have been overpaid shall be credited or re-funded to the taxpayer in accordance with the provisions of section 322.

§ 29.131-5 Countries which do or do not satisfy the similar credit requirement. A country satisfies the similar credit requirement of section 131 (a) (3) as to income tax paid to such country, either by allowing to citizens of the United States residing in such country a credit for the amount of income taxes paid to the United States, or, in imposing such taxes, by exempting from taxation the incomes received from sources within the United States by citizens of the United States residing in such country. A country does not satisfy the similar credit requirement of section 131 (a) (3) if it does not allow any credit to citizens of the United States residing in such country for income taxes paid to the United States, or, if such country does not impose any income taxes. If the country of which a resident alien is a citizen or subject does not allow a United States citizen residing in such country a credit for taxes paid to such country, no credit is allowed to such resident alien for taxes paid by him to such other foreign country.

§ 29.131-6 When credit for taxes may be taken. The credit for taxes provided by section 131 (a) may ordinarily be taken either in the return for the year in which the taxes accrued or in the return for the year in which such taxes were paid, dependent upon whether the accounts of the taxpayer are kept and his returns filed upon the accrual basis or upon the cash receipts and disbursements basis. Section 131 (d) allows the taxpayer to take the credit for taxes paid under section 131 (d) or under section 222 (c) or 238 (c) of the Revenue Act of 1924 or 1926, or under section 131 (d) of the Revenue Acts of 1928, 1932, 1934, 1936, or 1938, must be allowed in returns for all subsequent years, and no portion of any such taxes will be allowed as a deduction from gross income. If, however, under the provisions of § 29.43-1 an amount otherwise constituting gross income for the taxable year from sources within the United States is, owing to monetary, exchange, or other restrictions upon the payment of foreign currency, not includible in gross income of the taxpayer for such year, the credit for income taxes imposed by such foreign country with respect to such amount shall be taxable in the United States in any subsequent taxable year in which such amount or portion thereof is includible in gross income.

§ 29.131-7 Taxes of subsidiary corporation—(a) Domestic corporation con-
The operation of the limitations on the credit for foreign taxes paid by individuals may be illustrated by the following examples:

**Example (1).** In 1942, A, a citizen of the United States, had a net income for services rendered within the United States amounting to $50,000. He is entitled to a personal exemption of $500. The credit for foreign taxes allowable to A in his return for the calendar year 1942 is $14,788.67, computed as follows:

Income from sources within the United States: $50,000.00

Income from sources within Great Britain: $25,000.00

Total net income: $75,000.00

United States’ income tax on $75,000.00: $44,366.00

British income and profits taxes: $20,000.00

Limitation on British income and profits taxes under section 131 (b) (1) to determine tentative credit: $25,000.00 of $44,366.00 ———— 14,788.67

Total amount of credit allowable (sum of tentative credits, since such sum is within the limitation under section 131 (b) (2)): $13,732.20

The operation of the limitations provided by section 131 (b) on the credit for foreign taxes paid by corporations may be illustrated by the following example:

Example. The net income for the calendar year 1942 and the income and profits taxes paid or accrued to foreign countries and possessions of the United States in the case of a domestic corporation was as follows:

<table>
<thead>
<tr>
<th>Country</th>
<th>Net income</th>
<th>Less</th>
<th>Income tax professions taxes (paid or accrued)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>$50,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Great Britain</td>
<td>$25,000</td>
<td></td>
<td>$15,000</td>
</tr>
<tr>
<td>Canada</td>
<td>$10,000</td>
<td></td>
<td>$5,000</td>
</tr>
<tr>
<td>Argentine Republic</td>
<td>$50,000</td>
<td></td>
<td>$30,000</td>
</tr>
<tr>
<td>Puerto Rico</td>
<td>$10,000</td>
<td></td>
<td>$5,000</td>
</tr>
<tr>
<td>France (division)</td>
<td>$20,000</td>
<td></td>
<td>$10,000</td>
</tr>
<tr>
<td>France (branch)</td>
<td>$6,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Withheld.**

Net income: $50,000.00

Less: 85 percent on dividends received from domestic corporations ($50,000) ———— $42,500.00

Interest on obligations of the United States: $5,000.00

Normal tax net income (before the credit for adjusted excess profits net income): $23,500.00

Less: Adjusted excess profits net income: $105,000.00

Normal tax net income (after credit for adjusted excess profits net income): $157,500.00

Surtax net income ($157,500 minus $42,500 plus $105,000): $120,000.00

Total foreign net income: $120,000.00

United States tax (not including tax imposed under section 132): $37,800.00 (Surtax: $29,200.00)

**The computation of the credit is as follows:**

<table>
<thead>
<tr>
<th>Country</th>
<th>Net income</th>
<th>Less</th>
<th>Income tax professions taxes (paid or accrued)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Great Britain</td>
<td>$25,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Canada</td>
<td>$10,000</td>
<td></td>
<td>$5,000</td>
</tr>
<tr>
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<td>$50,000</td>
<td></td>
<td>$30,000</td>
</tr>
<tr>
<td>Puerto Rico</td>
<td>$10,000</td>
<td></td>
<td>$5,000</td>
</tr>
<tr>
<td>France (division)</td>
<td>$20,000</td>
<td></td>
<td>$10,000</td>
</tr>
<tr>
<td>France (branch)</td>
<td>$6,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The income and losses from all foreign countries and possessions of the United States, except the dividend from sources within France, were derived from branch operations. Dividends of $50,000 were received from a French corporation, a majority of the voting stock of which was owned by the domestic corporation. The French corporation paid to France income and profits taxes on income earned by it and in addition a dividend tax for the account of its shareholders. The income derived from the income deemed being withheld and paid at the source.

Income and profits tax paid or accrued: $157,500.00

Income and profits tax paid or accrued to France: $22,500.00

Income and profits tax paid or accrued to Canada: $5,104.76

Income and profits tax paid or accrued to Puerto Rico: None.

Income and profits tax paid or accrued to Argentine Republic: None.

Income and profits tax paid or accrued to Mexico: None.

Income and profits tax paid or accrued to France: $2,252.38

Income and profits tax paid or accrued to Puerto Rico: $6,000.00

Income and profits tax paid or accrued to Argentine Republic: $5,104.76

Income and profits tax paid or accrued to Mexico: None.
**Tentative credit**

The deduction of excess profits tax imposed by subchapter E of chapter 2 is not allowed in the computation of net income for the purposes of chapter 141.

However, in the determination of normal-tax net income, there is allowed as a credit against the tentative credits the amount of income subject to the tax imposed by subchapter E of chapter 2.

**Limitation under section 131 (b)**

The deduction of excess profits tax imposed by subchapter E of chapter 2 is not allowed in the computation of net income for the purposes of chapter 141.

However, in the determination of normal-tax net income, there is allowed as a credit against the tentative credits the amount of income subject to the tax imposed by subchapter E of chapter 2.

In such country bears to the entire normal-tax net income of such corporation computed without the allowance of the credit for adjusted excess profits net income.

Hence, the total amount of the credit shall not exceed the same proportion of the tax imposed by chapter 1 which the corporation's net income from sources within the country bears to the entire normal-tax net income of such corporation computed without the allowance of the credit for adjusted excess profits net income.

These principles may be illustrated by the following example:

Example. The following facts exist for the calendar year 1942 with respect to the A Corporation which makes its income tax returns on the calendar year basis:

- Normal-tax net income (computed without the credit for adjusted excess profits net income) $250,000
- Loss: Adjusted excess profits net income $75,000

**Normal-tax net income**

(credit for adjusted excess profits net income) $175,000

Net income from country A $100,000

Foreign tax paid on country A $25,000

Total normal tax and surtax $70,000

**Computation of foreign tax credit for purposes of normal tax and surtax**

$100,000 (net income from A country) $250,000 (normal-tax net income × 70%) $175,000

*Amount allowable as a credit* $28,000

In the event that net income is derived from more than one foreign country, the limitation provided in section 131 (b) shall be applied based upon the tax-payer's net income from all sources within the United States and the entire normal-tax net income of the corporation computed without the credit for adjusted excess profits net income.

**§ 29.131-9 Joint return by husband and wife.** In case of a husband and wife filing a joint return, the tax shall be determined after credits are allowed (sum of tentative credits for taxes paid or accrued to any foreign country or to any possession of the United States shall be computed upon the basis of the total income reported by or accrued against the spouses, and the limitations prescribed by section 131 (b) shall be applied with respect to the aggregate net income from sources within the country or to any possession of the United States and the aggregate net income from all sources, of the spouses.

**Returns and payment of tax**

- **§ 141.14101. Returns, tax amended by sec. 210 (b), Rev. Act 1939, re- pealing subsection (j) ; sec. 159 (a), Rev. Act 1939.**

- (c) Privilege to file consolidated income- and excess-profits-tax returns. An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making consolidated income and excess-profits-tax returns for the taxable year in lieu of separate returns. The consolidated returns shall be upon the condition that the affiliated group shall make both a consolidated income-tax return and a consolidated excess-profits-tax return for the taxable year, and that all corporations which at any time during the taxable year have been members of the affiliated group making a consolidated income-tax return consent to all the consolidated income- and excess-profits-tax regulations prescribed under this section. (b) Prior to the last day prescribed by law for the filing of such return. The making of a consolidated income-tax return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for the taxable year, the consolidated returns shall include the income of such corporation for such part of the year as it is a member of the affiliated group. Such corporation which is not a member of the affiliated group after March 31, 1942, of the last taxable year of such group before April 1, 1942, shall not be considered a member of the affiliated group for consolidated income-tax purposes for such year but shall be considered a member of such group for consolidated excess-profits-tax returns purposes for such year, and the consent required in the case of such corporation shall relate only to the consolidated excess-profits-tax regulations.

- (b) Return. Each member, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making consolidated income- and excess-profits-tax returns and of each corporation in the group, both during and after the taxable year, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income of excess-profits-tax liability and the various factors necessary for the determination of such liability, and the tax liability of such corporation or of such tax liability. Such regulations shall prescribe the amount of the net operating loss deduction of each member of the group which is attributable to a deduction allowed for a taxable year beginning in 1941 on account of property considered as destroyed or lost under section 272 (relating to war losses), and the allowance of the amount so prescribed as a deduction in computing the net income of the group shall be limited by the amount of the net income of such member.

- (c) Computation and payment of tax. In any case in which consolidated income-tax and excess-profits-tax returns are made or are required to be made, the taxes shall be determined, after credits are allowed, and adjusted in accordance with the regulations under this section (b) prescribed prior to the last day prescribed by law for the filing of such returns; except that the tax imposed under section 15 or section 294 shall be increased by 2 per centum of the consolidated corporation surtax net income of the affiliated group of includible corporations. Only one specific section of 658 provided in section 710 (b) shall be allowed for the entire affiliated group of corporations for the purposes of the tax imposed by Subchapter E of Chapter 2.

- (d) Definition of “Affiliated group.” As used in this section, an “affiliated group” means one or more domestic corporations connected through stock ownership with a common parent corporation by an inclusion for purposes of normal tax and surtax of the excess profits net income of each of the includible corporations (except the common parent corporation) owned directly by one or more of the other includible corporations; and

- (2) The common parent corporation owns directly or indirectly at least 80 per centum of the voting power of all classes of stock and at least 80 per centum of the value of the nonvoting stock of each of the includible corporations (except the common parent corporation) owned directly by one or more of the other includible corporations.

As used in this subsection, the term “stock” does not include nonvoting stock which is limited and preferred as to dividends.

- (e) Definition of “Includible corporation.” As used in this section, the term “includible corporation” means any corporation except—

- (1) Corporations exempt under section 211 from the tax imposed by this chapter.

- (2) Insurance companies subject to taxation under section 221.

- (3) Foreign corporations.

- (4) Corporations entitled to the benefits of section 251, for a taxable year ending in 1939, as a result of receiving a large portion of the income of nonincludible corporations which is attributable to a deduction allowed for a taxable year beginning in 1941 on account of property considered as destroyed or lost under section 272 (relating to war losses), and the allowable of the amount so prescribed as a deduction in computing the net income of the group shall be limited by the amount of the net income of such member.

- (f) Includible insurance companies. Despite the provisions of paragraph (a) of sub- section (e) of this chapter, two or more domestic insurance companies each of which is subject to taxation under the same section of this chapter shall be considered as includible corporations for the purposes of the application of subsection (d) to such insurance companies.

- (g) Subsidies formed to comply with foreign law. In the case of a domestic corporation owning or controlling directly or indirectly, 100 per centum of the capital stock (exclusive of directors’ qualifying shares) of a corporation organized under the laws of a contiguous foreign country and maintained solely for the purpose of complying with the laws of such country, the income from realization of property, such foreign corporation may, at the option of the domestic corporation, be taxed for the purpose and subject to the tax of the United States, by the application of Subchapter E of Chapter 2 as a domestic corporation.

(f) Suspension of running of statute of limitations. If a notice under section 279 (a) in respect of a deficiency for any taxable year.
Considered shall not be considered a member of such group after March 1942, of the last taxable year of such member of such group.

However, a corporation which is not a member of such a group at the time that one or more members of such group cease the ownership of voting stock, and at least 95 percent of each class of nonvoting stock, shall be considered a member of such a group at the time that one or more members of such group shall own at least 95 percent of the voting power of all classes of stock of such corporation at such time that at least 95 percent of each class of its nonvoting stock (not including nonvoting stock which is limited and preferred as to dividends) of another includible corporation. A corporation ceases to be a member of such an affiliated group at the time that one or more members of such group shall cease the ownership of voting stock of all classes of stock of such corporation at such time that at least 95 percent of its stock, at least 95 percent of at least 95 percent of each class of its nonvoting stock, and at least 95 percent of each class of its nonvoting stock (not including nonvoting stock which is limited and preferred as to dividends) of another includible corporation.

A corporation ceases to be a member of an affiliated group at the time that one or more members of such group cease the ownership of voting stock of all classes of stock of such corporation at such time that at least 95 percent of its stock, at least 95 percent of its stock and at least 95 percent of each class of its nonvoting stock, at least 95 percent of each class of its nonvoting stock (not including nonvoting stock which is limited and preferred as to dividends).

(c) Corporations to be included in consolidated returns. The privilege of filing consolidated income and excess profits tax returns is extended to all includible corporations constituting an "affiliated group," as defined in section 141 (d). In case a corporation is a member of an affiliated group for a fractional part of the year, the consolidated returns shall include the income of such corporation for the part of the year during which it is a member of the group. However, a corporation which is not a member of such a group after March 31, 1942, of the last taxable year of such a group which begins before April 1, 1942, shall not be considered a member of such group for consolidated income tax return purposes for such year, but shall be considered a member of such group for consolidated excess profits tax return purposes for such year. An "includible corporation" is defined by section 141 (e) to mean any corporation except:

(1) A corporation exempt under section 101 from the tax imposed by chapter 1;

(2) An insurance company subject to taxation under section 201 or 207 (except as provided in section 141 (d));

(3) A foreign corporation (except as provided in section 141 (g));

(4) A corporation entitled to the benefits of section 95 or section 95A of the Internal Revenue Code of 1939 by reason of receiving a large percentage of its income from sources within the possession of the United States;

(5) A corporation organized under the China Treaty Act, 1922; and

(6) A regulated investment company subject to tax under Supplement Q (sections 361 and 362).

The columns under income tax return and the consolidated excess profits tax return must include every includible corporation which, under the provisions of section 141, is a member of the affiliated group. Every corporation which may be included in the consolidated return for any taxable year beginning after December 31, 1941, and cannot be excluded at any time thereafter. If the election is exercised to treat such foreign corporation as a domestic corporation, then it must be included in both the consolidated income and excess profits tax returns of the affiliated group of which it is a member for each year for which such group makes or is required to make a consolidated return.

(1) Computation of tax. The surtax imposed by section 15 or section 204 upon an affiliated group making a consolidated income and excess profits tax return shall be increased by 2 percent of the consolidated corporate surplus net income. In case the consolidated corporate surplus net income exceeds $25,000, but not $50,000, the surtax on the first $25,000 shall be $5,000 instead of $5,250 as provided in section 15 (b) (2) in the case of corporations not making a consolidated return.

Sec. 142. Fiduciary income [as amended by secs. 7 (b), Rev. Act 1940, sec. 15, Rev. Act 1941; sec. 131 (c), Rev. Act 1942].

(a) Requirement of return. Every fiduciary (except a receiver appointed by a court of law in possession of part or all of the property of an individual) shall make under oath a return for any of the following individuals, estates or trusts for which he acts, stating specifically the items of gross income thereof and the deductions and credits allowed under this chapter in the computation of the income of which the purpose of complying with the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe:

(1) Every individual having a gross income for the taxable year of $500 or over, if single, or if married and not living with husband or wife;

(2) Every individual having a gross income for the taxable year of $1,000 or over, if married and living with husband or wife;

(3) Every estate the gross income of which for the taxable year is $1,000 or over;

(4) Every trust the net income of which for the taxable year is $100 or over, or the gross income of which for the taxable year is $1,000 or over, if more than $100 is required to be included in the net income; and

(5) Every estate or trust of which any beneficiary is a member, or of whose income any beneficiary is a member of the net income; and

(b) Joint fiduciaries. Under such regulations as the Commissioner with the approval of the Secretary may prescribe a return made by one or more joint fiduciaries shall be filed in the office of the collector of the district where such fiduciary resides shall be subject to audit with the above require-
ment. Such fiduciary shall make oath (1) that he has sufficient knowledge of the affairs of the individual, estate, or trust for which the return is made, to enable him to make the return, and (2) that the return is, to the best of his knowledge and belief, true and correct.

(c) Law applicable to fiduciaries. Any fiduciary required to make a return under this chapter shall be subject to all the provisions of law which apply to individuals.

§ 29.142–1 Fiduciary returns. Every fiduciary, or at least one of joint fiduciaries, must render returns of income for the taxable year if the gross income of such individual is $800 or over, if single, or if married and not living with husband or wife for any part of the taxable year; or if such individual is married and was living with husband or wife for the entire taxable year and his gross income for the taxable year is equal to, or in excess of, the credit allowed him by section 25 (b) (1) and (3) (computed without regard to the status of the minor or insane person as head of a family), or if such individual is married and was living with husband or wife for the entire taxable year and the aggregate gross income of both husband and wife is $1,200 or over, or if such individual is married and was living with husband or wife at the close of the taxable year but not during the entire taxable year and the aggregate gross income of both husband and wife is $1,200 or over, or if the aggregate gross income of both husband and wife is equal to, or in excess of, the credit allowed them by section 25 (b) (1) and (3) (computed without regard to the status of the minor or insane person as head of a family), or (b) Returns for estates and trusts.

For the estate for which he acts if the return of income for the taxable year is equal to, or in excess of, the credit allowed by section 25 (b) (1) and (3) (computed without regard to the status of either of them as head of a family), for the purpose of determining the liability of a fiduciary to render a return under the provisions of the preceding paragraph in cases where any beneficiary is a nonresident alien, the fiduciary shall render a return on Form 1041 and attach thereto a copy of the notice of appointment. If the sole beneficiary of an estate or trust who is a nonresident alien not engaged in trade or business within the United States at any time during the taxable year, the fiduciary shall make a return on Form 1041 for each nonresident alien beneficiary. (See further § 29.21–1.)

§ 29.142–2 Return by guardian or committee. A fiduciary acting as a guardian of a minor, or as the guardian or committee of an insane person, baring a gross income equal to, or in excess of, the credit allowed such person by section 25 (b) (1) and (3) (computed without regard to the status of the minor or insane person as head of a family) must make a return for such person on Form 1040 or 1040A and pay the tax, unless in the case of a minor the minor himself makes a return or causes it to be made. (See § 29.35–7.)

For the purpose of determining the liability of a fiduciary to render a return under the provisions of the preceding paragraph in cases where the minor or insane person is the incompetent in control of his or her own affairs but not living with husband or wife at the close of the taxable year, it is the aggregate gross income or the aggregate net income of both husband and wife which is controlling. (See § 29.51–1.)

§ 29.142–3 Returns in case of 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 for which the same trust instrument was used, a single return on Form 1041 for all such trusts, notwithstanding that they may arise from different instruments. If, however, one person acts as trustee for trusts created by different persons for the benefit of the same beneficiary, he shall make a return on Form 1041 for each trust separately.

§ 29.142–4 Return by receiver. A receiver who stands in the stead of an individual or corporation to receive a return of income and pay the tax for his trust, but a receiver of only part of the property of an individual or corporation need not. If the receiver acts for an individual the return shall be on Form 1040 or 1040A. When acting as 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 § 29.25.) A receiver in bankruptcy of the business of another who is not a citizen or resident, or a receiver in bankruptcy of a nonresident alien, or 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 mortgagee, 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 the corporation or corporation must make returns. (See also sections 147 and 148 (a).)

§ 29.142–5 Return for nonresident alien beneficiary—(a) United States business. If a citizen or resident fiduciary acts for an estate or trust of which the income is taxable to the United States, the benefits of the credits and deductions to which the beneficiary is entitled shall be determined on Form 1040 or 1040A. If the income is taxable to a single person having a similar income in a foreign country, the fiduciary shall render a return on Form 1040B for such nonresident alien, and pay any tax shown thereon to the United States. (See sections 143 and 211.) Unless such return is a true and accurate return of the nonresident alien beneficiary’s income from all sources within the United States, the benefits of the credits and deductions to which the beneficiary is entitled shall be determined on Form 1040 or 1040A.

§ 29.142–6 Returns for estates and trusts created by nonresident alien. A fiduciary acting as the receiver of the income of an estate or trust created by a nonresident alien engaged in a trade or business within the United States or resident alien engaged in a trade or business within the United States must make a return on Form 1040B for each nonresident alien beneficiary. (See §§ 215 and 251.) The fiduciary shall render a return on Form 1041 and attach thereto a copy of the notice of appointment. If the sole beneficiary of an estate or trust is a nonresident alien not engaged in trade or business within the United States at any time during the taxable year, the fiduciary shall make a return on Form 1041, as well as on Form 1040B. If there are two or more such nonresident alien beneficiaries, the fiduciary shall render a return on Form 1041 and also a return on Form 1040B for each nonresident alien beneficiary. (See further § 29.21–1.)

(b) No United States business. A citizen or resident fiduciary having the distributive fraction of the income of an estate or trust will not be required to make a return for any beneficiary of the estate or trust who is a nonresident alien not engaged in trade or business within the United States at any time during the taxable year, or in the case of beneficiary who is a nonresident alien, engaged in trade or business within the United States at any time during the taxable year if the entire amount of the tax on the income payable to such beneficiary has been withheld at the source. (See sections 143 and 211 (a).) A citizen or resident fiduciary having the distributive fraction of the income of an estate or trust shall make a return on Form 1040NB—If a beneficiary is a nonresident alien and the tax that his or her portion of the income or gain of the estate or trust is subject to withholding, the fiduciary shall make a return on Form 1040NB—If a beneficiary is a nonresident alien and the tax that his or her portion of the income or gain of the estate or trust is subject to withholding, the fiduciary shall make a return on Form 1040NB.
Income from such sources is $18,400 or less, the return (if a return is required to be filed) for the beneficiary shall be on Form 1040NB. If a return is required to be filed for a beneficiary who is a resident or citizen of the United States, or a resident of the United States, the return shall be on Form 1040. If a return is required to be filed for a beneficiary who is a nonresident alien, the return shall be on Form 1040NR. If a return is required to be filed for a beneficiary who is a resident or citizen of the United States, or a resident of the United States, the return shall be on Form 1040. If a return is required to be filed for a beneficiary who is a nonresident alien, the return shall be on Form 1040NR.

If a return is required to be filed for a beneficiary who is a resident or citizen of the United States, or a resident of the United States, the return shall be on Form 1040. If a return is required to be filed for a beneficiary who is a nonresident alien, the return shall be on Form 1040NR. If a return is required to be filed for a beneficiary who is a resident or citizen of the United States, or a resident of the United States, the return shall be on Form 1040. If a return is required to be filed for a beneficiary who is a nonresident alien, the return shall be on Form 1040NR.

The return shall be made on Form 1040, and the due date of the return shall be the last day prescribed for the return of the income of the estate or trust. If a return is required to be filed for a beneficiary who is a nonresident alien, the return shall be on Form 1040NR. If a return is required to be filed for a beneficiary who is a resident or citizen of the United States, or a resident of the United States, the return shall be on Form 1040. If a return is required to be filed for a beneficiary who is a nonresident alien, the return shall be on Form 1040NR.

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wherever occurring therein and inserting in

(c) Subsection (a) shall apply only with respect to the period beginning with the
tenth day after the date of the enactment of this Act.

Sec. 109. INTEREST IN BONDS.

No amendment made by this title shall apply in any case where its application would be contrary to any treaty obligation of the United States.

Sec. 160. FOREIGN CORPORATIONS.

Aliens (or, if an individual, an alien fiduciary) and partnerships, composed in whole or in part of aliens, are subject to withholding in accordance with Article VII of the tax convention and protocol between the United States and Sweden, effective January 1, 1940.

Sec. 29.143-1. Withholding tax at source—(a) Withholding of interest from bonds, mortgages, or deeds of trust, or other similar obligations.

The tax must be withheld at the source from any interest paid in connection with any of the above obligations in respect to bonds, mortgages, or deeds of trust, or other similar obligations of a corporation containing a tax-free covenant, or contained in a tax-free covenant and issued on or after January 1, 1934.

The tax need not be withheld on any interest paid on or after January 1, 1934, with respect to amounts paid prior to October 31, 1942, unless such interest is paid in respect to bonds held by a person carrying on a trade or business in the United States or, with respect to amounts paid prior to October 31, 1942, was engaged in trade or business in the United States or, with respect to amounts paid prior to October 31, 1942, was engaged in trade or business and not having any office or place of business therein, and by striking out "or not having any office or place of business therein" wherever occurring therein.

(2) Section 29.143-1 (relating to withholding of the tax at the source on nonresident aliens) is amended by striking out "and not having any office or place of business therein" and by striking out "or has an office or place of business therein".

(3) The amendments made by this subsection shall apply only with respect to the period beginning with the tenth day after the date of the enactment of this Act.

(4) The amendments made by this subsection shall apply only with respect to the period beginning with the tenth day after the date of the enactment of this Act.

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on or after January 1, 1934. The interest on such obligations is not subject to the withholding provisions of section 143 (a) but falls within the class of interest described in section 143 (b).

In the case of corporate bonds or other obligations of a corporation containing a tax-free covenant and issued before January 1, 1934, paid to an individual, a fiduciary, or a partnership, whether resident or nonresident, withholding of a tax of 2 percent is required, except that if the liability assumed by the obligor in connection with such a covenant does not exceed 2 percent of the interest, withholding is required at the rate of 50 percent (27 1/2 percent prior to October 31, 1942) in the case of a nonresident alien, or a nonresident partnership composed wholly of nonresident aliens.

Any ground nor shall the tax so paid be included in the gross income of the bondholder. The amount of the tax may nevertheless be claimed by the bondholder as a credit against the total amount of income tax paid by him in accordance with section 143 (d). The tax withheld at the source upon tax-free covenant bond interest included in the income of an estate or trust taxable to the beneficiaries thereof (including the grantor of a trust subject to section 166 or 167) is allocable, pro rata, as a credit against (1) the tax required to be withheld by the fiduciary from the income of nonresident alien beneficiaries and (2) the total tax computed in the returns of the beneficiaries required to make returns. In the case, however, of corporate bonds or other obligations containing an appropriate tax-free covenant, the corporation paying for someone else, pursuant to its agreement, a State tax or any tax other than a Federal tax may deduct such payment as interest paid on indebtedness.

§ 29.143-2 Fixed or determinable annual or periodical income. Only fixed or determinable annual or periodical income is subject to withholding. The Internal Revenue Code specifically includes in such income, interest, dividends, rents, royalties, and nonresident alien benefits, compensations, remunerations, and emoluments. But other kinds of income are included, as, for instance, royalties.

Income is fixed or determinable if it is to be paid in amounts indefinitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained. The income need not be payable 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 less determinable or periodical.

A casher working by the week for a farm employer, where the wages which are paid or credited monthly receive determinable periodical income. The share of the fixed or determinable annual or periodical income of an estate or trust from sources within the United States which is distributable, whether distributed or not, or which has been paid or credited during the taxable year to a nonresident alien beneficiary of such estate or trust, is fixed or determinable annual or periodical income within the meaning of section 163 (b). The income derived from the sale in the United States of cultural commodities pursuant to Public Law 455 (78th Congress), approved April 29, 1943, shall not be subject to deduction and withholding of income tax at the source (see section 5 (b) of such Public Law 45).

The following items of fixed or determinable annual or periodical income from sources within the United States received by a citizen of France residing in France, or a corporation organized under the laws of France, are not subject to the withholding provisions of the Internal Revenue Code, since such income is exempt from Federal income tax under the provisions of the tax convention between the United States and France, signed April 27, 1932, and effective January 1, 1936:

(a) Exemption and credit for dependents of a nonresident alien other than a resident of China at the time of such distribution;

(b) Exemption from withholding of income tax at the source of income paid, or credited, in the United States to a nonresident alien other than a partnership resident in China; or

(c) Exemption from withholding of income tax at the source, where the income is paid to or credited to a nonresident foreign corporation.
The person paying such income should be notified by letter from the French citizen or corporation, as the case may be, that the income is exempt from tax alone under the provisions of the convention and section 119 (a) (1) (B) (1). Such letter from a citizen of France shall contain his address and a statement that he is a citizen of France residing in France. The letter from such corporation shall contain the address of the office or place of business and a statement that it is a corporation organized under the laws of the Republic of France, and shall be signed by an officer of the corporation giving his full name and title. The letter of notification or a copy thereof should be immediately forwarded by the recipient to the Commissioner of Internal Revenue, Withholding Returns Section, Washington, D.C.

As to items of income received on or after January 1, 1940, by individual residents of Sweden or by Swedish corporations or other entities and not subject to the withholding provisions of the Internal Revenue Code, see the tax convention between the United States and Sweden, effective January 1, 1940, and the regulations thereunder.

A nonresident alien individual not engaged in trade or business within the United States at any time within the taxable year is subject to the tax imposed by section 211 (a) on gross income and is not subject to any personal exemption or credit for dependents. Although a nonresident alien individual who is engaged in trade or business within the United States is entitled to the personal exemption of $1,400 (and a credit for dependents if he is a resident of Canada or Mexico), he is subject to the normal tax and the surtax imposed by sections 11 and 12 by reason of the provisions of sections 101 (b) and 102 (a) of the act of May 26, 1924 (43 Stat. 52), whether or not the obligation contains a tax-free covenant. In the case of interest payments on obligations of a State, Territory, or any political subdivision thereof, or the obligations of possessions of the United States. (See section 22 (b) (4).) Ownership certificates are not required to be filed in connection with interest payments on bonds, mortgages, or deeds of trust, or other similar obligations issued by an individual, a partnership, or a corporation, or where the owner is unknown, an ownership certificate for each such obligation is required in such cases whether or not the obligation contains a tax-free covenant. However, ownership certificates need not be filed by a nonresident alien, a nonresident foreign corporation, or where the owner is unknown, an ownership certificate for each issue of such obligations shall be filed when interest coupons for any amount are presented for payment. Ownership certificates (Form 1001) shall also be filed in the case of interest paid on or after January 1, 1942, on obligations of the United States or any agency or instrumentality thereof, regardless of the status of the owner of the obligations. Ownership certificates are required to be filed in connection with interest payments on such bonds, mortgages, or deeds of trust, or other similar obligations of a domestic or resident foreign corporation qualifying under section 119 (a) (1) (B), or of a nonresident foreign corporation. Ownership certificates (Form 1001) shall also be filed in the case of interest paid on or after January 1, 1942, on obligations of the United States or any agency or instrumentality thereof, regardless of the status of the owner of the obligations.

As to items received on or after January 1, 1941, by individual residents of Canada and not subject to the withholding provisions of the Internal Revenue Code, see the tax convention between the United States and Canada, effective January 1, 1941, and the regulations thereunder.

In the case of interest payments on obligations of the United States or of any agency or instrumentality thereof, are received unaccompanied by ownership certificates, unless the owner of the bonds is known to the bank to which the coupons are presented for payment, and the bank is satisfied that the owner is a person, who is not required to file an ownership certificate, the bank shall require of the payee a statement showing the name and address of the person from whom the coupons were received, identifying the payee, and alleging that the owner of the bonds is unknown to the payee. Such statement shall be forwarded to the Commissioner with the monthly (quarterly, for the calendar year 1943 and subsequent calendar years) return on Form 1012. The bank shall also require the payee to prepare a certificate on Form 1001, crossing out "owner" and inserting "payee" and entering the amount of the.
interest, and shall stamp or write across the face of the certificate "Statement furnished," adding the name of the bank. Ownership certificates are required in connection with interest paid on registered bonds, except that if ownership certificates are not furnished by the owner of such bonds, ownership certificates must be prepared by the withholding agent.

§ 29.143-5 Form of certificate for citizens and nonresident partnerships and unknown owners. For the purpose of § 29.143-4, Form 1001 shall be used in preparing ownership certificates of citizens or residents of the United States (individual or fiduciary), resident partnerships, and unknown partnerships of all of the members of which are citizens or residents. If the obligations are issued by a nonresident foreign corporation having a fiscal or paying agent in the United States, Form 1000 should be modified to show the name and address of the fiscal agent or the paying agent in addition to the name and address of the debtor corporation.

§ 29.143-6 Form of certificate for nonresident partnerships and unknown owners. For the purpose of § 29.143-4, Form 1001 shall be used in preparing ownership certificates of nonresident partnerships composed in whole or in part of nonresident aliens, (c) of nonresident foreign corporations, and (d) where the owner is unknown.

§ 29.115-7 Return and payment of tax withheld. Every withholding agent shall make on or before March 15 an annual return on Form 1013 of the tax withheld from interest on bonds or other obligations of corporations and interest on obligations issued by the United States or any agency or instrumentality thereof on or after March 1, 1941. This return should be filed with the collector for the district in which the withholding agent is located. The withholding agent shall be monthly, in the case of bonds, Form 1012 on or before the 20th day of the month following that for which the return is made. The ownership certificates, Forms 1000 and 1001, must be forwarded to the Commissioner with the monthly return. If the forms report interest from which no tax is to be withheld need not be listed on the return, the number of such forms submitted shall be entered in the space provided for the monthly return, for the calendar year 1943 and subsequent calendar years the withholding agent shall make a quarterly return on Form 1012 on or before the last day of the month following the quarter for which the return is made. The ownership certificates, Forms 1000 and 1001, must be forwarded to the Commissioner with the quarterly return. Forms 1001 should be listed as the quarterly return of which Form 1000 need not be listed on the return, the number of such forms submitted and the total amount of interest paid of the tax withheld on such of the forms as report interest from which the tax is to be withheld shall be entered in the spaces provided. If Form 1000 is modified to show the name and address of a fiscal or paying agent in the United States (see § 29.143-5), Forms 1012 and 1013 should be likewise modified. In the case of interest on obligations of the United States or of any agency, or instrumentality thereof the withholding agents shall be: (1) The Commissioner of the Public Debt for interest paid by checks issued through the Bureau of the Public Debt; (2) the Treasurer of the United States for all interest paid by him, whether by check or otherwise; and (3) each Federal reserve bank for all interest paid by it, whether by check or otherwise. Every person required to deduct and withhold any tax from income other than bond interest shall make an annual return thereof to the collector on or before March 1 and showing the amount of tax required to be withheld from each nonresident alien, nonresident partnership composed in whole or in part of nonresident aliens, nonresident foreign corporations, and unknown owners. For the purpose of § 29.143-4, Form 1001 shall be used in preparing ownership certificates of citizens or residents of the United States (individual or fiduciary), resident partnerships, and unknown partnerships of all of the members of which are citizens or residents. If the obligations are issued by a nonresident foreign corporation having a fiscal or paying agent in the United States, Form 1000 should be modified to show the name and address of the fiscal agent or the paying agent in addition to the name and address of the debtor corporation.

§ 29.143-7 Return and payment of tax withheld. Every withholding agent shall make on or before March 15 an annual return on Form 1013 of the tax withheld from interest on bonds or other obligations of corporations and interest on obligations issued by the United States or any agency or instrumentality thereof on or after March 1, 1941. This return should be filed with the collector for the district in which the withholding agent is located. The withholding agent shall be monthly, in the case of bonds, Form 1012 on or before the 20th day of the month following that for which the return is made. The ownership certificates, Forms 1000 and 1001, must be forwarded to the Commissioner with the monthly return. If the forms report interest from which no tax is to be withheld need not be listed on the return, the number of such forms submitted shall be entered in the space provided for the monthly return, for the calendar year 1943 and subsequent calendar years the withholding agent shall make a quarterly return on Form 1012 on or before the last day of the month following the quarter for which the return is made. The ownership certificates, Forms 1000 and 1001, must be forwarded to the Commissioner with the quarterly return. Forms 1001 should be listed as the quarterly return of which Form 1000 need not be listed on the return, the number of such forms submitted and the total amount of interest paid of the tax withheld on such of the forms as report interest from which the tax is to be withheld shall be entered in the spaces provided. If Form 1000 is modified to show the name and address of a fiscal or paying agent in the United States (see § 29.143-5), Forms 1012 and 1013 should be likewise modified. In the case of interest on obligations of the United States or of any agency, or instrumentality thereof the withholding agents shall be: (1) The Commissioner of the Public Debt for interest paid by checks issued through the Bureau of the Public Debt; (2) the Treasurer of the United States for all interest paid by him, whether by check or otherwise; and (3) each Federal reserve bank for all interest paid by it, whether by check or otherwise.

§ 29.143-8 Ownership certificates in the case of fiduciary or joint ownership. If any 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. The ownership certificate should show the name of the estate or trust, in addition to the name and address of the fiduciary. If bonds are owned jointly by two or more persons, a separate ownership certificate must be executed in behalf of each of the owners.

§ 29.143-9 Return of income from which tax was withheld. The annual return of the income from which the tax was withheld shall be included, in gross income in the return required to be made by the recipient of the income without deduction for such payment of the tax but any tax so withheld shall be credited against the total income tax as computed in the taxpayer's return. (See however, § 29.143-5.) If the tax is paid by the collector of internal revenue or the withholding agent it shall not be re-collected from the other, regardless of the original liability therefor, and in such event no penalty will be asserted against either person for failure to return or pay the tax where no fraud or purpose to evade payment is involved.

Tax withheld at the source upon fixed or determinable annual or periodic income paid to nonresident alien beneficiaries is deemed to have been paid by the persons ultimately liable for the tax upon such income. Accordingly, if a person is subject to the taxes imposed by section 11, 13, 14, or 15 of the taxable year beginning after December 31, 1942, the victory tax imposed by section 45B, upon any portion of the income of a nonresident alien estate or trust, the part of any tax withheld at the source which is properly allocable to the income so taxed to such person shall be credited against the amount of the income tax computed upon his return, and any excess shall be credited against any income, war-profits, or excess-profits tax, or installment thereof, then due from such person, and any balance shall be refunded.

Sec. 124. PATIENTS OF CORPORATION INCOME TAX AT SOURCES [as amended by sec. 6 (b), Rev. Act 1949; secs. 167 (a), 163 (a), Rev. Act 1941; secs. 159 (a), 169 (a), Rev. Act 1921].

In the case of foreign corporations subject to the provisions of the corporation income tax act, there shall be deducted and withheld at the source in the same manner and upon the same items of income as provided in sec-
1942, to tax-free covenant bonds) the deduction
provided, the same manner and subject to the same
may be provided such rate (not less than
with respect to dividends shall be reduced to
section shall apply only with respect to the
amended by
Section 144 a tax equal to 15 percent in the case of corporations
under the laws of Canada.
Withholding is required in the case of interest paid on obligations issued by
the United States or any agency or instrumentality thereon or on March
1, 1941. (See §§ 29.22 (b) (4) - 5 and 29.22 (b) (5) - 6, relating to the taxation of such
interest, relating to ownership certificates.)
Withholding of a tax at the rate of 2 percent is required in the case of interest
paid to a nonresident foreign corporation; upon bonds or other obligations of
a corporation issued prior to January 1, 1934, and containing a tax-free cover-
rent, if the liability assumed by the source has been reduced to 5 percent as
may be provided by treaty with such country.
A tax of 30 percent (27½ percent prior to October 31, 1942) is required to be
withheld from dividends (other than dividends distributed by a corporation
organized under the China Trade Act, 1922, to a resident of China) from sources
within the United States paid to a nonresident foreign corporation except that
such rate of 30 percent (27½ percent prior to October 31, 1942) shall be re-
duced, in the case of corporations organized under the laws of any country in
North, Central, or South America, or in the West Indies, or of Newfoundland,
to such rate (not less than 5 percent) as may be provided by treaty with such
country. Under the regulations prescribed pursuant to the tax convention
between the United States and Canada (ratifications exchanged June 15, 1942)
the rate of tax to be withheld at the source has been reduced to 15 percent effective
June 27, 1942, in the case of nonresident corporations organized under
the laws of Canada. Dividends paid to such corporations are subject to
withholding unless the source has been required to withhold at the reduced rate of 5 percent.
Dividends paid by a foreign corporation are not, however, subject to withholding unless such corpo-
ration is engaged in trade or business within the United States or, in the case of dividends paid before October 31, 1942,
if such corporation was engaged in trade or business within the United States or
had an office or place of business therein) and more than 5 percent of the gross in-
come of such foreign corporation for the 3-year period ending with the close of its
taxable year preceding the declaration of such dividends (or for such part of such
year as the corporation has been in existence) was derived from sources
within the United States as determined under the provisions of section 119. (See
§ 29.143-2.)
For withholding in the case of divi-
dends distributed by a corporation organ-
ized under the China Trade Act, 1922, see
§§ 29.143-3 and 29.258-4.
Under the provisions of subsection (b), as amended by section 108 of the Revenue
Act of 1942, the rate of tax withheld at the source shall not exceed 2½ percent in the case of interest on bonds, mort-
gages, or deeds of trust or other similar obligations of a corporation within the
provisions of section 143 (a) (1) were it not for the fact that the maturity date of
such obligations has been extended on or after January 1, 1934.

§ 29.144-2 Aids to withholding agents in determining liability for withholding of tax. Since no withholding of tax on
bond interest, dividends, or other income is required in the case of a resident for-
corporation (see § 29.143-1), no person paying such income should be noti-
tified by a letter from such corporation that it is not subject to the withholding
provisions of the Internal Revenue Code. The letter from the corporation shall
contain the address of its office or place of business in the United States and be
signed by an officer of the corporation giving his official title. Such letter of
notification, or copy thereof, should be immediately forwarded by the recipient
to the Commissioner of Internal Revenue, Withholding Returns Section, Wash-
ington, D. C. Such notices should be followed in the case of resident part-
nerships, composed in whole or in part of nonresident aliens, not subject to
the withholding provisions of the Code except to the extent of interest on tax-free cover-
rent bonds. The letter should be signed by a member of the firm.
When a payor corporation, or any other person (including a nominee), having the
control, receipt, custody, disposal, or payment of dividends has no definite knowl-
edge of the status of a shareholder, the tax
should be withheld if the shareholder's address is outside the United States.
If the shareholder's address is within the
United States, it may be assumed that such
shareholder is a citizen or a resident thereof.
Unless the name and style of the shareholder are such as to indicate clearly that he is a nonresident alien, an
address in care of another person in the
United States does not of itself warrant
the treating of the shareholder as a non-
resident alien. If a shareholder changes
his address from a place without the
United States to a place within the
United States, the tax should be withheld unless
proof is furnished showing that he is a
citizen or a resident of the United States.
A person's written statement that he is a
citizen, or resident of the United States,
may be relied upon by the payor of in-
come as proof that such person is a citi-
en or resident of the United States.

The following tables of withholding rates under the Internal Revenue Code,
as modified by tax conventions between the United States and other countries,
have been prepared for the purpose of making a summary of such rates readily
available to withholding agents:
I. FOR THE PERIOD ENDING OCTOBER 31, 1942

<table>
<thead>
<tr>
<th>Class of taxpayer</th>
<th>Corporate bond interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>With tax-free covenant and limited interest Jan. 1, 1942</td>
<td>1. Citizen or resident individual, fiduciary, or partnership.</td>
</tr>
<tr>
<td>Without tax-free covenant and limited interest Jan. 1, 1942</td>
<td>2. Nonresident, individual, fiduciary, or partnership.</td>
</tr>
<tr>
<td>If corporation or resident foreign corporation.</td>
<td>3. Domestic corporation or resident foreign corporation.</td>
</tr>
<tr>
<td>If corporation or resident foreign corporation.</td>
<td>4. Nonresident foreign corporation.</td>
</tr>
<tr>
<td>If corporation or resident foreign corporation.</td>
<td>5. Individual, fiduciary, or partnership, resident of a country, and corporation organized under laws of Canada.</td>
</tr>
<tr>
<td>If corporation or resident foreign corporation.</td>
<td>6. Unknown owner.</td>
</tr>
</tbody>
</table>

2. Salary or compensation for personal services rendered in the United States is subject to withholding in the case of nonresident aliens, resident of Canada or Mexico, and taxable within the United States for personal services rendered in the United States or at the rate of 2.5% with respect to dividends. 3. Taxes not over 2 percent of the tax.

II. FOR THE PERIOD ENDING OCTOBER 31, 1942

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<th>Class of taxpayer</th>
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<td>6. Unknown owner.</td>
</tr>
</tbody>
</table>

2. Salary or compensation for personal services rendered in the United States is subject to withholding in the case of nonresident aliens, resident of Canada or Mexico, and taxable within the United States for personal services rendered in the United States or at the rate of 2.5% with respect to dividends. 3. Taxes not over 2 percent of the tax.

III. FOR THE PERIOD ENDING OCTOBER 31, 1942

<table>
<thead>
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<th>Class of taxpayer</th>
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<tbody>
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2. Salary or compensation for personal services rendered in the United States is subject to withholding in the case of nonresident aliens, resident of Canada or Mexico, and taxable within the United States for personal services rendered in the United States or at the rate of 2.5% with respect to dividends. 3. Taxes not over 2 percent of the tax.
declared terminated and of the tax for the last preceding taxable year or so much of such tax as is unpaid, whether or not the time otherwise allowed for resident or nonresident, who intends to depart from the United States and whose tax obligations are not in default in making any return, or the amount of the tax or deficiency in the tax, in addition to all other penalties, be added as is due and payable,

(b) Security for payment. 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 required of him or furnish such other security as may be approved by the Commissioner.

(c) Same; exemption from section. If security is approved and accepted pursuant to the provisions of this section, every alien, resident or nonresident, who intends to depart from the United States, may, at his discretion, waive any of the requirements placed on the taxpayer by this section.

(d) Departure of alien. No alien shall depart from the United States unless he first procures from the collector or agent in charge, a certificate that he has complied with all the obligations imposed upon him by the income, war-profits, and excess-profits tax laws.

(1) Addition to tax. If a taxpayer violates any requirements of the section, the amount of the tax or deficiency in the tax, together with interest at the rate of 6 per centum per annum from the time the tax became due.

§ 39.146-1 Termination of the taxable period by Commissioner. (a) Section 146 provides that in the case of a taxpayer when the tax must be computed, the Commissioner, with the approval of the Secretary, 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 make the return required or furnish such other security as may be approved by the Commissioner that he will make the return required or furnish such other security as may be approved by the Commissioner that he will make the return required or return and pay the tax or taxes required to be paid. If such security is approved and accepted pursuant to the provisions of this section, the amount of taxes due for the taxable period, or by furnishing such other security as may be approved by the Commissioner.

(b) Exemption as provided in paragraph (c) of this section an alien who intends to depart from the United States will be required to file a return of income on Form 1040C and to obtain a certificate of compliance, with income tax obligations from the collector or internal revenue agent in charge. A certificate of compliance is attached to and made a part of Form 1040C. The return of the taxpayer may furnish as security a surety bond on Form 1040D, approved by the Commissioner, secured by deposit of bonds or notes of the United States, equal in their total par value to an amount not exceeding double the amount of the tax or taxes in respect of which the bond is furnished. A form of a "certificate of compliance" is made a part of Form 1040D. Bonds complying with the provisions of this section, if properly executed and accepted, may be deposited with the Commissioner, and will be accepted as evidence of the taxpayer's compliance with the income tax laws.
salaries, wages, premiums, annuities, commissions, remunerations, encomiums, or other fixed or determinable gains, profits, and income, (each described in § 29.142-11 or 12), or of $500 or more in any taxable year, or, in the case of such payments made by the United States, the officers or employees thereof, the states having provided for, and to 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 names and addresses of the recipients of such payment.

(b) Returns regardless of amount of 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, (2) in the case of payments of interest upon obligations of the United States or any agency or instrumentality thereof, and (3) in the case of collections of items (not payable in the United States) of interest or dividends, the collection of foreign payments and interest upon the bonds and similar obligations of the United States or any agency or instrumentality thereof, the ownership certificates, when duly filed, shall constitute and be treated as returns of information and in such cases no return of information on Form 1099 will be required. (See also § 29.142-1.)

(c) Recipient to furnish name and address. 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 person paying the income.

§ 29.147-1 Return of information as to payments of $500. All persons making payment of person on a fixed or determinable income of $500 or more in any calendar year must render a return thereof to the Commissioner for such year on or before February 15 of the following year, except as specified in §§ 29.147-3 to 29.147-5, inclusive. A return shall be made in each case on Form 1099, accompanied by transmittal Form 1099 showing the number of returns filed, except as specified in § 29.147-3, and the distributions to beneficiaries of a trust or of an estate shall be made on Form 1041 in lieu of Forms 1099 and 1098. The street or post-office address of the person whose return of the payment lives should be stated, if possible. If 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 § 29.148-2.)

Sums paid in respect of life insurance, annuities, or annuity contracts which are required to be included in gross income under §§ 29.22 (b) (1)–(2), 29.22 (b) (2)–(3), and 29.22 (b) (4)–(7) come within the meaning of the term "fixed or determinable income" and are required to be reported in returns of information as required by this section, except that payments in respect of policies surrendered before maturity and lapsed policies need not be reported.

Fees for professional services paid to attorneys, physicians, and members of other professions come within the meaning of the term "fixed or determinable income" and are required to be reported in returns of information as required by this section.

For the purposes of a return of information, an amount is deemed to have been paid when it is credited or set apart to the taxpayer without any substantial limitation as to the time, form, or manner of payment or condition upon which payment is to be made, and which is available to him in cash at any time, and its receipt with held within his own control and disposition.

§ 29.147-2 Return of information as to payments to employees. The names of all employees to whom payments of $500 or more are made in any calendar year, the returns of which are fixed or determinable, shall be reported on Form 1099, by each employer of such employees. The returns shall show the name and address of the recipient, the amount of the payment, and date and place of payment. Returns of information required to be filed shall constitute and be treated as returns of information and in such cases no return of information on Form 1099 will be required. (See also § 29.147-1.)

(c) Return to furnish name and address. 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 person paying the income.

§ 29.147-3 Return of information as to payments of $500. All persons making payment of $500 or more in any calendar year must render a return of information as required by this section.

(b) Returns regardless of amount of 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, (2) in the case of payments of interest upon obligations of the United States or any agency or instrumentality thereof, and (3) in the case of collections of items (not payable in the United States) of interest or dividends, the collection of foreign payments and interest upon the bonds and similar obligations of the United States or any agency or instrumentality thereof, the ownership certificates, when duly filed, shall constitute and be treated as returns of information and in such cases no return of information on Form 1099 will be required. (See also § 29.147-1.)

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Fees for professional services paid to attorneys, physicians, and members of other professions come within the meaning of the term "fixed or determinable income" and are required to be reported in returns of information as required by this section.

For the purposes of a return of information, an amount is deemed to have been paid when it is credited or set apart to the taxpayer without any substantial limitation as to the time, form, or manner of payment or condition upon which payment is to be made, and which is available to him in cash at any time, and its receipt withheld within his own control and disposition.

§ 29.147-2 Return of information as to payments to employees. The names of all employees to whom payments of $500 or more are made in any calendar year, the returns of which are fixed or determinable, shall be reported on Form 1099, by each employer of such employees. The returns shall show the name and address of the recipient, the amount of the payment, and date and place of payment. Returns of information required to be filed shall constitute and be treated as returns of information and in such cases no return of information on Form 1099 will be required. (See also § 29.147-1.)

(c) Return to furnish name and address. 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 person paying the income.

§ 29.147-3 Return of information as to payments of $500. All persons making payment of $500 or more in any calendar year must render a return thereof to the Commissioner for such year on or before February 15 of the following year, except as specified in §§ 29.147-3 to 29.147-5, inclusive. A return shall be made in each case on Form 1099, accompanied by transmittal Form 1099 showing the number of returns filed, except as specified in § 29.147-3, and the distributions to beneficiaries of a trust or of an estate shall be made on Form 1041 in lieu of Forms 1099 and 1098. The street or post-office address of the person whose return of the payment lives should be stated, if possible. If 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 § 29.148-2.)

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For the purposes of a return of information, an amount is deemed to have been paid when it is credited or set apart to the taxpayer without any substantial limitation as to the time, form, or manner of payment or condition upon which payment is to be made, and which is available to him in cash at any time, and its receipt withheld within his own control and disposition.

§ 29.147-2 Return of information as to payments to employees. The names of all employees to whom payments of $500 or more are made in any calendar year, the returns of which are fixed or determinable, shall be reported on Form 1099, by each employer of such employees. The returns shall show the name and address of the recipient, the amount of the payment, and date and place of payment. Returns of information required to be filed shall constitute and be treated as returns of information and in such cases no return of information on Form 1099 will be required. (See also § 29.147-1.)

(c) Return to furnish name and address. 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 person paying the income.
the items, an information return on Form 1099 is required to be filed by the bank or collecting agent accepting the items for collection, if the foreign item is paid to a citizen or resident of the United States (individual or fiduciary), or a partnership any member of which is a citizen or resident, and if the amount of the foreign item is received in any taxable year to an individual, a partnership or a fiduciary is $500 or more. Such forms accompanied by Form 1096 shall be forwarded to the Commissioner of Internal Revenue, Returns Distribution Section, Washington, D.C., on or before February 15 of each year. The term "collection" includes the following: (a) Returns Distribution of the foreign items paid in any taxable year to an individual, a partnership, or a corporate fiduciary, or a resident partnership any member of which is a citizen or resident, amounting to $100 or more for each calendar year, shall render an information return on Forms 1096 and 1099. A separate Form 1099 must be prepared for each shareholder, upon which will be shown the name and address of the shareholder to whom such payment was made, and the amount paid. These forms, accompanied by a letter of transmission, should be filed with the Commissioner of Internal Revenue, Returns Distribution Section, Washington, D.C., on or before February 15 of each year.

The periodical distributions of earnings on running installment shares of stock paid or credited by a building and loan association to its holders of that class of stock are dividends within the meaning of section 115(a). The sum received upon withdrawal from a building and loan association in excess of the amounts paid in on account of membership fees and stocks, consisting of accumulated profits, constitutes a dividend within the meaning of section 115(a). As to when a stock dividend is taxable as a dividend see section 115(f).

(b) In the case of a distribution which is made from a depletion or depreciation reserve, or which for any other reason is deemed by the corporation to be not taxable or partly nontaxable to its shareholders, the corporation will fill in the information on both sides of Form 1099 and forward this form, together with Forms 1096, to the Commissioner of Internal Revenue, Returns Distribution Section, Washington, D.C., not later than February 1 of the following year. Upon receipt of this information the Commissioner will advise the corporation by letter as to any apparent errors made by the corporation in computing the non-taxable portion of the distribution in order that the corporation may, if time permits, furnish such advice to its shareholders before the shareholders file their income tax returns for the year in which the distribution was made.

(c) In any case in which it is impossible to file the return within the time prescribed in this section, the corporation may, upon a showing of such fact, obtain a reasonable extension of time for filing the return. The extension of time must be forwarded to the Commissioner of Internal Revenue, Practice and Procedure Division, Washington, D.C., on or before the date prescribed for filing the return.

§ 29.148-3 Return of information respecting contemplated dissolution or liquidation—(a) Making and filing of re-
§ 29.148-4 Information respecting compensation of officers and employees. If the corporation subject to taxation under chapter 1 which during any taxable year has paid to any officer or employee of the corporation, salary, commission, bonus, or other compensation for personal services rendered, in an aggregate amount in excess of $75,000 (in whatever form paid), shall in respect of each such taxable year, make and file, in duplicate, a schedule on Form 29.1513-1, as a part of its income tax return, in accordance with the instructions contained in the prescribed return. Such schedule shall contain the following information:

(a) Name and address of corporation.
(b) The name and address of the officer, employees, or other persons rendering such compensation.
(c) The amount of salary paid, (d) amount of commission paid, (e) amount of bonus paid, (f) amount of other compensation paid, and (g) total compensation paid.

The term "paid" as used in this section means "paid or accrued" or "paid or incurred" which shall be construed according to the method of accounting upon the basis of which the net income of the corporation is computed.

Upon receipt of the returns by the collector, the schedules will be detached and forwarded by the collector to the Commissioner of Internal Revenue, Records Division, Washington, D.C.

§ 29.1513-1 Collection of income tax of certain foreign persons. Every person doing business in a foreign country, or for or on behalf of a foreign corporation, shall file with the Collector of Internal Revenue, as provided in section 29.1513-1, a return on Form 29.1513-1, giving the name and address of the business, the amount of any income derived from the business, and the amount of any income tax due on such income.

Any person holding a license under the Revenue Act of 1928 or any prior Act will not be required to renew such license.

§ 29.1516-1 Scope. Supplement B (sections 281 to 300, inclusive) prescribes that the taxes imposed by chapter 1 shall be applicable to the income of estates or of any kind of property held in trust, including:

(a) Income accumulated in trust for the benefit of unborn or uncertain persons, and income accumulated or held for future distribution under the terms of the will or trust, and income which is to be held or distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant or incompetent person, which is to be held or distributed as the court may direct.

(b) Income received by executors or administrators during the period of administration of estates or of such a trust. Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(c) Gross reference. For return made by fiduciary, see section 212.

§ 29.161-1 Imposition of the tax. Every person doing business in a foreign country, or for or on behalf of a foreign corporation, shall be subject to such regulations as the Commissioner may prescribe, with the approval of the Secretary, and whoever knowingly undertakes to collect such tax shall be fined not more than $5,000 and be suspended for not more than one year, or both.

§ 29.161-2 Returns of income from foreign countries. Every person doing business in a foreign country, or for or on behalf of a foreign corporation, shall be subject to such regulations as the Commissioner may prescribe, with the approval of the Secretary, and whoever knowingly undertakes to collect such tax shall be fined not more than $5,000 and be suspended for not more than one year, or both.
The establishment, acquisition, maintenance or operation of a public cemetery not operated for profit.

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the legatees, heirs, or beneficiaries, but the amount so allowed shall be included in computing the net income of the legatees, heirs, or beneficiaries whether distributed or not. As used in this subsection, "income which is to be distributed currently" includes income for the taxable year of the estate or trust which, within the taxable year of the estate or trust, became payable to the legatee, heir, or beneficiary.

(c) Any amount allowed as a deduction under this paragraph shall be included in computing the net income of the estate or trust for the taxable year during which such amounts so paid, credited, or to be distributed to the legatee, heir, or beneficiary bears the same ratio to such amount as the part of the amount so paid, credited, or to be distributed on the date of the interval which bears to the period of the interval.

(d) Rules for application of subsections (b) and (c). For the purposes of subsections (b) and (c), (1) Amounts distributable out of income or corpus. In cases where the amount paid, credited, or to be distributed or amounts accrued, but not distributed, out of other than income, the amount paid, credited, or to be distributed (except under a gift, bequest, devise, intestate succession, or a distribution) during the taxable year of the estate or trust shall be considered as income of the estate or trust which is paid, credited, or to be distributed if the aggregate of such amounts so paid, credited, or to be distributed does not exceed the distributable income of the estate or trust for its taxable year. If the aggregate of such amounts so paid, credited, or to be distributed during the taxable year of the estate or trust in such cases exceeds the distributable income of the estate or trust for its taxable year, the amount so paid, credited, or to be distributed to the legatee, heir, or beneficiary shall be considered income of the estate or trust for its taxable year which is paid, credited, or to be distributed, and amount which bears the same ratio to such amount as the part of the amount which bears the same ratio to such amount as the part of such amount which bears the same ratio to such amount as the part of the amount so paid, credited, or to be distributed to the legatee, heir, or beneficiary bears to the aggregate of such amounts so paid, credited, or to be distributed to the legatees, heirs, and beneficiaries for the taxable year of the estate or trust. For the purposes of this paragraph "distributable income" means either (A) the net income of the estate or trust computed with the deductions allowed under subsections (b) and (c) in cases to which this paragraph does not apply, or (B) the net income of the estate or trust minus the deductions provided in subsections (b) and (c) in cases to which this paragraph does apply. Except as otherwise provided in this paragraph, any part of the gross income, without limitation, which purports to be included in the taxable year of any permanent or permanently set aside for the purposes in the manner specified in section 23(o), or to be used exclusively for religious, literary, educational purposes, or for the prevention of cruelty to children or animals, or for the use of any part of the gross income, without limitation, which purports to be included in the taxable year of any permanent or permanently set aside for the purposes in the manner specified in section 23(o), or to be used exclusively for religious, literary, educational purposes, or for the prevention of cruelty to children or animals, or for the...
which the item is claimed as a deduction a statement to the effect that the items have not been claimed or allowed as deductions from the gross estate of the decedent under section 812 (b) and a waiver of any and all right to have the item allowed at any time as a deduction under section 812 (b). For items not deductible, see section 24. Against the net income of the estate or trust there are income tax credits for, which see sections 25 and 163.

From the gross income of the estate or trust there are also deductible (either in lieu of, or in addition to, the deductions referred to in the preceding paragraph of this section) the following:

(a) Any part of the gross income of the estate or trust for its taxable year which, by the terms of the will or of the instrument creating the trust, is paid or permanently set aside during such year for charitable, etc., uses or purposes referred to or described in section 162 (a). This deduction is in lieu of that authorized by §§ 29.163-1 to 29.163-7, inclusive, in the case of individual taxpayers.

(b) Any income of the estate or trust for its taxable year which is to be distributed currently during such year to a legatee, heir, or beneficiary, whether or not such income is actually distributed. For this purpose, it is provided in section 162 (b) that "income which is to be distributed currently" includes income of the estate or trust which, within its taxable year, becomes payable to the legatee, heir, or beneficiary.

(c) Any income of the estate of a deceased of its taxable year which is properly paid or credited during such year to a legatee or heir, and any income either of such an estate or of a trust for its taxable year which is similarly paid or credited during that year to a legatee, heir, or beneficiary if there was vested in the fiduciary a discretion either to distribute or to accumulate such income.

(d) Income described in subparagraphs (a), (c), and (d) of section 162 (a) which is included in the income of the grantor of the trust for its taxable year which is taxable to the grantor of the trust, whether distributed to him or not. In the case of a similar trust, where the trust income is taxable to the beneficiary, was used, pursuant to the terms of the will or trust, for the provision of the income thereof accumulated to B, the income becomes payable to B, the beneficiary, on July 1, 1942, and the income of the trust was to be accumulated until that date and then to be distributed to B at such time as the trustee in his discretion decides, if the trustee on December 31, 1942, decides to distribute the accumulated income to B, the income becomes payable to B on December 31, 1942, whether distributed to him or not. In the case of a testamentary trust, which is valid, the income which is a gain or an increase in value is payable to the beneficiaries at the time that the trustee in his discretion decides to distribute the income.

(e) Any income of the class described in subparagraphs (d) and (f) of section 162 (a) which is properly credited during such year to a legatee, heir, or beneficiary.

(f) Any income of a decedent of its taxable year which is taxable to the grantor of the trust under section 162 (b) and § 29.162-2 (b). Any amount considered to be payable out of the income of the trust for its taxable year is determined under section 162 (d) and § 29.162-2 (b).

Any income described in (b) and (c) of this section as being deductible from the gross income of the estate or trust shall be included in computing the net income of the legatee, heir, or beneficiary, whether distributed to them or not. As to the amount of income of the estate or trust which is considered paid, credited, or to be distributed, and the time thereof, for the purposes of the deduction under (b) and (c) of this section and the inclusion in income of the legatee, heir, or beneficiary, see section 162 (d) and § 29.162-2 (b).

Any income of the estate for its taxable year not properly paid or credited during such year to a legatee or heir is deductible.

All income either of the estate or of the trust for its taxable year which is not similarly paid or credited during that year to a legatee, heir, or beneficiary in case there was vested in the fiduciary a discretion either to distribute or to accumulate such income (see (c) of this section).

In all such cases the tax with respect to such income included in the income of the estate or trust for its taxable year is payable by the fiduciary, except where the income is taxable to the grantor of the trust or where, as provided in the next paragraph, it is deductible by the estate or trust for such taxable year (and is includible in the income of the legatee or beneficiary).

Income described in subparagraphs (1), (2), (4), and (5) of paragraph (c) may, in some cases, be deductible by the estate or trust under (b) of this section. It is expressly provided in section 162 (b) that such income of the estate or trust for its taxable year, which, within its taxable year, becomes payable to the legatee, heir, or beneficiary, is deductible by the estate or trust. Thus, if income of a trust is to be accumulated until A, the beneficiary, reaches his twenty-first birthday, which is the first birthday of 1942, the income of the trust (assuming the income tax returns of the trust are made on the calendar year basis) for the calendar year 1942 is to be deducted by the trust under section 162 (a), from its net income for 1942 and is to be included in the income of A for his taxable year in which December 31, 1942, falls. In the case of a similar trust, where the twenty-first birthday of B, the beneficiary, was on July 1, 1942, and the income of the trust was to be accumulated until that date and then to be distributed to B at such time as the trustee in his discretion decides, if the trustee on December 31, 1942, decides to distribute the accumulated income to B, the income becomes payable to B on December 31, 1942, whether distributed to him or not. In the case of a testamentary trust, which is valid, the income which is a gain or an increase in value is payable to the beneficiaries at the time that the trustee in his discretion decides to distribute the income.

Any income of an estate or trust for its taxable year which is taxable to the grantor of the trust under section 162 (b) and § 29.162-2 (b), for which a statutory allowance paid a widow is not deductible from gross income, except to the extent that under the principles of § 29.162-2 (c) such allowance is taxable to the widow. If real estate is sold by the devisee or heir thereof, whether before or after settlement of the estate, the income is taxable individually on any profit derived.

The tax upon the net income of the estate or trust shall be paid by the fiduciary (see section 161 (b)). If the tax has been properly paid on the net income of an estate or trust for any taxable year, the net income on which the tax is so paid is not, generally, in the hands of the distributees thereof (the legatee, heir, or beneficiary) taxable as income to him, her, or it. The income, if income, to the extent payable in a subsequent taxable year of the estate or trust to the distributee after the first 65 days of such subsequent taxable year, may be required to be included in the income of the distributee under section 162 (d) (2). See § 29.162-2 (b).

Liability for the payment of the tax attaches to the person of the executor or administrator up to and after his discharge. If prior to distribution any action for his discharge he had notice of his tax obligations or failed to exercise due diligence in ascertaining whether or not such obligations existed, for the tax due and unpaid to the extent of the duties of administration or settlement thereof, see section 2467 of the Revised Statutes, as amended by section 618 of the Revenue Act of 1924. Liability for the tax also follows the assets of the decedent's estate in the hands of the devisee, devisees, legatees, and distributees of the estate. The same considerations apply to trusts. See § 29.162-2. Allocation of estate and trust income to legatees and beneficiaries—(a) Allocation among annulees.
Section 162 (d) (1) applies to all cases in which the executor or trustee can or must (for example, by the terms of the trust instrument or will) pay out of income, or any part of a gift, bequest, devise, or inheritance out of other than income, except that no income is to be allocated under it to a legatee, heir, or beneficiary of a lump sum gift, bequest, devise, or inheritance. It applies in all cases of annuities where any deficiency in the amount to be paid can be made up by a payment out of corpus of the trust. It also applies to such cases as to all annuities, whether to be paid or credited at intervals and the executor or trustee has discretion whether to pay or credit such amounts out of income or corpus, regardless of the source out of income or corpus of the estate or trust instrument or will) pay the whole amount. If an annuity is paid, credited, or to be distributed tax-free, that is, the portion of the corpus and any accumulated income to be distributed at intervals (is obtained.

"Net income," as used in this section, means the statutory net income of the trust under the Internal Revenue Code before the application of section 162 (b) and (c) (but, as stated in the preceding sentence, such amount is to be reduced by the deductions allowed under subsections (b) and (c) of section 162 in the case of amounts to which section 162 (d) (1) does not apply. "Income," as thus used, must be determined in accordance with the following principles: First, such "income" means, in general, the amount which under the applicable law of estates and trusts is considered income available for distribution to the life tenant, legatee, or beneficiary, as the case may be. Second, there must be eliminated from the income of the estate or trust, determined in accordance with the terms of the trust instrument and State law, items of income which are not includible in income of an individual for Federal income tax purposes. Therefore, the "income," referred to in clause (B) of section 162 (d) (1), may exceed net income and thus be treated as distributable income under section 162 (d) in cases where items which are deductible for Federal income tax purposes available for one of the trust instrument or State law, not to be used to reduce income available for distribution but to be allocated to corpus.

The application of section 162 (d) (1), in general, may be illustrated by the following example:

Example. Pursuant to the terms of the will of A, a trust is established on January 1, 1940, to pay $5,000 a year to B in quarterly installments at the end of every three months, and upon the death of B to pay the corpus and any accumulated income to his estate. Its distributable income considered to be currently due. The receipts and expenditures of the trust for 1942 are as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable stock dividend</td>
<td>$1,000</td>
</tr>
<tr>
<td>Income from rents</td>
<td>$3,000</td>
</tr>
<tr>
<td>Tax-exempt interest from State bonds</td>
<td>$1,000</td>
</tr>
<tr>
<td>Gain from sale of capital asset held for 10 months</td>
<td>$1,000</td>
</tr>
<tr>
<td>Deductions</td>
<td>$200</td>
</tr>
<tr>
<td>Other deductible expenditures</td>
<td>$1,300</td>
</tr>
</tbody>
</table>

In accordance with the terms of the trust instrument, stock dividends are to be allocated to corpus, gain from sale of a capital asset held more than one year is to be allocated to income, and the trustee's commissions are to be charged to income. However, the other expenditures above ($1,300) are of a nature which under the terms of the trust instrument are to be charged to corpus. The amount of the income of the trust to be deducted by it for 1942 and included in the beneficiary's income for such year is $3,300, the greater of the statutory net income and the distributable trust income includible in gross income, determined as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statutory Net Income (Prior to Application of Section 162 (b) and (c))</td>
<td></td>
</tr>
<tr>
<td>Gross income:</td>
<td></td>
</tr>
<tr>
<td>Rent received</td>
<td>$1,000</td>
</tr>
<tr>
<td>Rents</td>
<td>$3,000</td>
</tr>
<tr>
<td>Long-term capital gain (50 percent taken into account, section 117 (b))</td>
<td>$600</td>
</tr>
<tr>
<td>Deductions:</td>
<td></td>
</tr>
<tr>
<td>Trustees' commissions</td>
<td>$200</td>
</tr>
<tr>
<td>Other deductible expenditures</td>
<td>$1,300</td>
</tr>
<tr>
<td>Net income</td>
<td>$3,000</td>
</tr>
</tbody>
</table>

Trust Income Under Clause (B) of Section 162 (d) (1)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td></td>
</tr>
<tr>
<td>Rents</td>
<td>$3,000</td>
</tr>
<tr>
<td>Interest from State bonds</td>
<td>$1,000</td>
</tr>
<tr>
<td>Gain on sale of asset</td>
<td>$1,000</td>
</tr>
<tr>
<td>Net income</td>
<td>$5,000</td>
</tr>
</tbody>
</table>

Expenses allocated to income:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trustee's commissions</td>
<td>$200</td>
</tr>
<tr>
<td>Eliminating items not includible in gross income</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>$1,000</td>
</tr>
<tr>
<td>Excluded gain on sale of asset</td>
<td>$1,700</td>
</tr>
</tbody>
</table>

Income determined under section 162 (d) (1) (B) $3,300

"Net income" and "income" for the purposes of section 162 (d) (2) do not include income of a prior taxable year, even though such income may be included consideration of the estate or trust for the current taxable year under section 162 (d) (2). This rule may be illustrated by the following example:

Example. Under the terms of a trust, established in 1925, the trustees are to accumulate the income thereof until A reaches his twenty-first birthday, and then to pay A such accumulated income, and on each December 31 thereafter, to pay B $5,000, out of income of the trust, if income is available, or, if not, out of corpus of the trust. A became 21 years of age on June 30, 1942. The returns of the trust and of A and B are made on the calendar year basis. Under section 162 (b), the income of the trust for that part of 1942 on and before June 30, 1942, is to be considered income of the trust for the year 1942, and the income of the trust for 1942, if so allocated, is to be distributed currently to A. In computing the distributable income of the trust for 1942 the return of A and B is to be made on the calendar year basis. The trust instrument provides that the amount payable to A after payment of A's income for 1942 and B's income for 1942 (after payment of B's commissions) or out of corpus to the extent income is insufficient. The receipts and expenditures for the trust for 1942 are as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
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</thead>
<tbody>
<tr>
<td>Taxable stock dividend</td>
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<tr>
<td>Gain from sale of capital asset held for 10 months</td>
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</tr>
<tr>
<td>Deductions</td>
<td>$200</td>
</tr>
<tr>
<td>Other deductible expenditures</td>
<td>$1,300</td>
</tr>
</tbody>
</table>

In accordance with the terms of the trust instrument, stock dividends are to be allocated to corpus, gain from sale of a capital asset held more than one year is to be allocated to income, and the trustee's commissions are to be charged to income. However, the other expenditures above ($1,300) are of a nature which under the terms of the trust instrument are to be charged to corpus. The amount of the income of the trust to be deducted by it for 1942 and included in the beneficiary's income for such year is $3,300, the greater of the statutory net income and the distributable trust income includible in gross income, determined as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statutory Net Income (Prior to Application of Section 162 (b) and (c))</td>
<td></td>
</tr>
<tr>
<td>Gross income:</td>
<td></td>
</tr>
<tr>
<td>Rent received</td>
<td>$1,000</td>
</tr>
<tr>
<td>Rents</td>
<td>$3,000</td>
</tr>
<tr>
<td>Long-term capital gain (50 percent taken into account, section 117 (b))</td>
<td>$600</td>
</tr>
<tr>
<td>Deductions:</td>
<td></td>
</tr>
<tr>
<td>Trustees' commissions</td>
<td>$200</td>
</tr>
<tr>
<td>Other deductible expenditures</td>
<td>$1,300</td>
</tr>
<tr>
<td>Net income</td>
<td>$3,000</td>
</tr>
</tbody>
</table>

Net income: $3,000

(b) Allocation among income beneficiaries and legatees. Section 162 (d) (2) applies in cases where income of the estate or trust for any period becomes payable on a date more than 65 days after the beginning of its taxable year. It applies in every case where income of the estate or trust is paid, credited, or to be distributed to a legatee, heir, or beneficiary, other than a legatee, heir, or beneficia-
In the trust instrument or will to make income to the beneficiary prior to the twenty-first birthday of the beneficiary (or his prior death), and income in which the date of distribution occurs (the beneficiary's twenty-first birthday or his prior death) is not income which is includible in the taxpayer's income for the taxable year but is income which becomes payable in the taxable year of the trust in which the date of distribution occurs. In any case, income becomes payable at the end of the period from which such income is derived, whether or not such income is actually paid. Such income has a present right, whether or not such income is actually paid, to be distributed to the legatee or beneficiary.

The application of section 162 (2) (d), in general, may be illustrated by the following examples:

Example 1. An existing trust makes its income returns on the cash receipts and disbursements basis and on the basis of a calendar year accounting period. Under the terms of the trust, the income for the calendar year (1942, for the purposes of section 162 (b) and (c)) shall be included in its income for 1941, and, under the law applicable to 1941, the 1941 trust income is included in the 1941 income return as a deduction, but the 1941 trust income not distributable until June 30, 1942, is not allowable as a deduction for the purposes of section 162 (b) as income for the taxable year 1942 which becomes payable on June 30, 1942, and, accordingly, will be deducted by the trust for 1942.

Assuming the beneficiary makes his income tax return on the cash receipts and disbursements basis and on the calendar year accounting period. Under the terms of the trust, income is includible in the income of the trust for 1941 which is to be distributed out of the income of the estate for the taxable year 1942 the estate will take a deduction of $12,000 and the legatee will take the same amount (out of the total of $18,000 received in his hands) as a distribution from the estate.

Example 2. An estate which came into existence January 1, 1941, but which received its first income June 30, 1941, will be considered a distribution out of the income for the entire period of administration, of which the last 12 months is the calendar year 1942 and the most recently accumulated income is the $6,000 for the last six months of 1942. Accordingly, for 1942 the estate will take a deduction of $12,000 and the legatee will take the same amount (out of the total of $18,000 received in his hands) as a distribution from the estate.

Example 3. An estate which came into existence January 1, 1941, but which received its first income June 30, 1941, will be considered a distribution out of the income for the entire period of administration, of which the last 12 months is the calendar year 1942 and the most recently accumulated income is the $6,000 for the last six months of 1942. Accordingly, for 1942 the estate will take a deduction of $12,000 and the legatee will take the same amount (out of the total of $18,000 received in his hands) as a distribution from the estate.

The rule also applies in the case of distribution out of income for a period which does not include any part of the current taxable year. Thus, in the case of a trust established on January 1, 1941, which accumulates the income in the first year of the trust (June 30, 1941) and pays out thereafter (more than 65 days after the close of the prior taxable year) distributes the prior year's accumulation, the 1941 accumulation that may be distributed in 1942, will be considered a distribution out of the trust for 1942 which is to be distributed in 1942.

The prior period, the income of which becomes distributable in the taxable year, is a period of more than 12 months, the only the income of the last 12 months of such period is considered to be income which is to be distributed during the cur-
Section 162 (d)(3)(A) applies in the type of cases described in section 162 (d)(2) but only where income is paid, credited, or to be distributed within the first 65 days of the taxable year of the estate or trust.

In such cases, if income of the estate or trust for a period beginning before the beginning of the taxable year becomes payable within the first 65 days of the taxable year, the tax on the amount of such period not falling within the taxable year is considered to be paid, credited, or distributed on the last day of the preceding taxable year if the amount of income for any period paid, credited, or to be distributed to a legatee or beneficiary during the taxable year of the estate or trust is less than the amount of income already paid, credited, or to be distributed to legatees or beneficiaries for such period, such amount will be considered paid, credited, or distributed from the most recently accumulated income of the period. For example, a trust which makes its returns on the calendar year basis and which is to distribute the income for the taxable year of the estate or trust is allowed for the purpose of the normal tax, be allowed as credits against net income. A credit for dependents is not allowable to an estate or trust.

Any amount paid, credited, or to be distributed within the first 65 days of any taxable year of the estate or trust is included in computing the net income of any legatee, heir, or beneficiary, the estate or trust shall be allowed the credits provided in section 25 (a) in respect of the personal exemption allowed for the purpose of the normal tax, as follows: Where the amount of the interest specified in section 25 (a) is in excess of the net income of the estate or trust, the proportionate share of such interest which each beneficiary is required to include in computing his net income for the purpose of the normal tax, be allowed as credits against net income in addition to the credits allowed to him under section 25 (a), his proportionate share of such amounts is as specified in section 25 (a) as are, under this Supplement, required to be included in computing his net income for the purpose of the normal tax, be allowed as credits against net income in addition to the credits allowed to him under section 25 (a). (See section 25). (For reduction of credits on account of amortizable bond premium, see § 29.125-9.)
SEC. 164. DIFFERENT TAXABLE YEARS [as amended by sec. 111 (d), Rev. Act 1942].

If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received. In the case of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries, the amounts received by such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(3) Income received from estates, trusts, estates, and in any case within the taxable year in which the amounts received were received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(4) Taxable years to which amendments applicable. The amendments made by this section shall be applicable to taxable years beginning after December 31, 1941. The amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(5) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(6) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(7) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(8) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(9) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(10) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(11) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(12) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(13) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(14) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(15) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(16) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(17) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(18) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(19) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(20) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(21) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(22) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(23) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(24) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(25) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.

(26) If the plan, or a part thereof, for which the Federal Insurance Contributions Act applies, is not applicable under section 162 (2), (6), and (7) of this section, the amounts received by the beneficiaries from such plan shall be treated as income for the taxable year during which the amounts received are received, and the amounts received from such plan shall be treated as income for the taxable year during which the amounts received are received.
A plan is for the exclusive benefit of employees or their beneficiaries even though it may cover former employees as well as present employees and employees who are temporarily away from work, for example, in the military or naval forces. A plan covering only former employees may qualify under section 165(a) if it complies with the provisions of section 165(a) (3) (D) with respect to coverage, and section 165(a) (4), with respect to contributions and benefits, as applied to all of the former employees. The term "beneficiaries" of an employee within the meaning of section 165 includes the estate of the employee, dependents of the employee, persons who are the natural objects of the employee's bounty, and any person of the trust in order for the trust to obtain any exemption for such years. The trust instrument and of the employer as the result of an erroneous actuarial computation. If, however, the surplus of $50,000 had been accumulated as a result of a change in the benefit provisions of the plan, the $50,000 could not revert to the employer because such surplus would not be the result of an erroneous actuarial computation. The "liabilities" as used in section 165(a) (2) includes both fixed and contingent obligations to employees. For example, if 1,000 employees are covered by a trust plan and plan for a monthly pension, while the remaining 700 employees have not completed the required period of service, contingent obligations to such 700 employees have nevertheless arisen which constitute "liabilities" within the meaning of that term. It must be impossible for the employer (or other nonemployee) to recover any sum of money which amounts as remain in the trust because of "erroneous actuarial computations" after the satisfaction of all fixed and contingent obligations, and the trust instrument as to the extent allowed by local law. It is not essential that the employee relinquish all power to modify or terminate the right of certain employees covered by the trust, but it must be impossible for the trust funds to be used or diverted for purposes other than for the exclusive benefit of his employees or their beneficiaries. As used in section 165 (a) (2), the phrase "purposes other than for the exclusive benefit of the employees or their beneficiaries" includes all objects or aims not solely designed for the proper satisfaction of all liabilities to employees or their beneficiaries covered by the trust. "liabilities" as used in section 165 (a) (2), the phrase "purposes other than for the exclusive benefit of his employees or their beneficiaries" includes all objects or aims not solely designed for the proper satisfaction of all liabilities to employees or their beneficiaries covered by the trust. The definitions of "liabilities" as used in section 165 (a) (2) is to prevent the trust device from being used for the principal benefit of shareholders, officers, persons whose principal duties consist in supervising the work of other employees, or highly paid employees, or as a means of avoidance, a trust will not be exempt unless it is part of a plan which satisfies the coverage requirements of section 165 (a) (3). See § 26.165-5 as to the effective date of section 165 (a) (3). The percentage requirements in section 165 (a) (3) (A) refer to a percentage of all the active employees, including employees of a corporation and those in the armed forces of the United States, if such employees are eligible under the plan. The application of section 165 (a) (3) (A) may be illustrated by the following example: Example. An employer adopts a plan at a time when he has 1,000 employees. The plan provides that all full-time employees who have been in the employment of the employer for a period of two years and have reached the age of 30 shall be eligible to participate. The plan also requires the participating employees to agree to contribute 3 percent of their monthly pay. At the time the plan is made effective 100 of the 1,000 employees had not been in the employment for a period of two years.
Fifty of the employees were seasonal employees whose customary employment was for not more than five months in any calendar year. Twenty-five of the employees were part-time employees whose customary employment was for not more than 20 hours in any one week. One hundred and fifty of the full-time employees who had been employed for two years or more had not yet reached age 30.

Section 165 (a) (3) (A) will be met if 540 employees are covered by the plan, as shown by the following computation:

1. Total employees with respect to which the percentage requirements are applicable (1,000 minus 100 plus 50 plus 50) 825
2. Employees not eligible to participate because of age requirements 160
3. Total employees eligible to participate 665
4. Percentage of employees in Item 1 eligible to participate .81
5. Minimum number of participating employees to qualify the plan (60 percent of 665) 400

If only 70 percent, or 578, of the 825 employees are included in the percentage requirements, then 462 (80 percent of 578) participating employees would satisfy the percentage requirements.

If a plan fails to qualify under the percentage requirements of section 165 (a) (3) (A), it may still qualify under subparagraph (B) of such section provided always that (as required by paragraphs (b) and (c) of section 165 (a) the plan's eligibility provisions, benefits, and contributions do not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or the highly compensated employees.

Section 165 (a) (5) sets out certain classifications that will not in themselves be considered discriminatory. However, those so designated are not intended to be exclusive. Thus, plans may qualify under section 165 (a) (3) (B) which are limited to employees who have reached a designated age or have been in the employment of a designated number of years or are employed in certain designated departments or are in other classifications.

Provided, That the effect of covering only such employees is not to discriminate in favor of officers, shareholders, employees whose principal duties consist in supervising the work of other employees, or the highly compensated employees. For example, if there are 1,000 employees, and the plan is written for only salaried employees, and consequently only 500 employees are covered, 450 employees are not covered. The fact alone will not justify the conclusion that the plan does not meet the coverage requirements of section 165 (a) (3) (B) as long as the classification as established does not discriminate in favor of shareholders, officers, employees whose principal duties consist in supervising the work of other employees, or the highly paid employees.

An employer may designate several trusts or a trust or trusts and an annuity plan or plans as one plan which is intended to qualify under section 165 (a) (3) in which case all of such trusts and plans taken as a whole may meet the requirements of such section. The fact that such combination of trusts and plans fails to qualify as one plan does not prevent the combination of trusts and plans from meeting the requirements of section 165 (a).

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Although a plan may provide for termination at will by the employer, this will not of itself prevent a trust from qualifying as exempt under section 165 (a). However, in certain cases that fact may necessitate some provision in the plan which will preclude such termination from effective operation of the provisions of such section. This may occur where, for example, certain officers or highly compensated employees are at the inception of the plan within a few years of retirement age and the operation of the plan will fund and vest their benefits in a short period, thus resulting in such disfavor in favor of such officers or highly compensated employees.

§ 29.165-5 Effect of amendments to section 165 (a), (b), (c), and (d) of the Revenue Act of 1942 (set forth immediately preceding § 29.165-1) makes the requirements of section 165 (a) (1), (2), (3), (4), and (5) inapplicable for taxable years beginning prior to January 1, 1940, it need not be included in the plan if the employee so desires for the calendar year 1943. Also, if he did not have until the beginning of the fiscal year basis he will have until December 31, 1942, if any one of the provisions of section 165 (a) (1), (2), (3), (4), and (5) inapplicable for taxable years beginning prior to January 1, 1943, in the case of a stock bonus, pension, profit-sharing, or annuity plan in effect on or before December 31, 1942, for such taxable years a trust will be exempt if it complies with section 165 (a) (1) and (2), except that for taxable years beginning prior to January 1, 1949, it need not comply with provisions of previous year. The provisions of § 19.165-1 of this chapter are applicable in such a case to a taxable year beginning after December 31, 1941, and prior to January 1, 1942. A plan which requires the use of a trust not in effect as of September 1, 1942, if there was no valid trust in existence at that time. A plan requiring the purchase of an annuity contract on or before September 1, 1942, to effect such a plan is put into effect and ending December 31, 1942.

In the case of a plan in effect on or before September 1, 1942, such as was paid from the contributions made after December 31, 1942, and (6) inapplicable for taxable years beginning after December 31, 1942. In such cases an employee who is under the plan meeting the requirement of section 165 (a) (2), except that for taxable years beginning prior to January 1, 1943, an employer having such a plan may be made in connection with any distribution.

If it is exempt under section 165 (a) purchases an annuity contract for an employee and distributes it to the employee in a year for which the trust is exempt, the contract will have a cash surrender value which may be available to an employee by surrendering the contract, such cash surrender value will not be considered income to the employee unless and until the contract is surrendered.

If pension or annuity payments are continued after the death of a retired employee to his beneficiary, such beneficiaries will be required to include such pension or annuity payments in income to the same extent that the deceased employee would have been required to include such payments if he were alive to receive such payments. See the first paragraph of this section.

§ 29.165-6 Taxability of beneficiary under a trust which meets the requirements of section 165 (a). Section 165 (b) and (c) relates to the taxation of the beneficiary of an employee's trust. If an employee makes a contribution for the benefit of an employee to a trust for the taxable year of the employer which ends within or with a taxable year of the trust for which the trust is exempt under section 165 (a), the employee is not required to include such contributions in his income except in the year or years in which such contributions are distributed or made available to him immediately in the case of contributions to an exempt trust whether the employee's rights in the contributions to the trust are forfeitable or nonforfeitable either at the time the contributions are made to the trust or thereafter. The distribution from such an exempt trust when received or made available will be taxable to him as if it were an annuity to the extent provided in section 22 (b) (2). The provisions of section 165 (b) relate only to distributions by a trust which is exempt under section 165 (a) for the taxable year of the trust in which the distribution is made. If a trust is exempt under section 165 (a) for the taxable year in which the distribution occurred but was not so exempt for one or more prior taxable years, the amount of such tax may be reduced by the part thereof shown to the satisfaction of the Commissioner to be properly allocable to employer's contributions or earnings of the trust premiums or other taxable income by the employee or to earnings of the trust previously accounted for as taxable income by the trust. Where the distribution occurs in a taxable year of the trust for which it is not exempt under section 165 (a), the taxability of such distribution will depend on the taxable status of the trust under other provisions of the Internal Revenue Code at the time of the distribution. If such trust was not exempt for one or more prior taxable years, the adjustments outlined above may be made in connection with any distribution.

If the total distributions payable with respect to any employee under a trust that in the year of distribution are paid to the distributee within one taxable year of the employee's separation from the service, the amount of such distribution, to the extent which exceeds the amount contributed by the employee, shall be considered a gain from the sale or exchange of a capital asset held for more than six months. For example, if, under a profit-sharing trust, the total distributions to which an employee is entitled are paid in a taxable year of the trust for which it is exempt to the employee in the year in which he retired, the payments received by the employee, or to his widow if he dies during the course of his employment, the amount received by the employee or widow to the extent exceeds the employee's contributions will be considered a gain from the sale or exchange of a capital asset held for more than six months, to be taken into account to the extent provided in section 117 (a) if the trust if the trust was not exempt for one or more taxable years prior to the year of distribution, see the first paragraph of this section.
§ 29.165-7 Treatment of beneficiary of a trust not exempt under section 165 (a). Any contribution made by an employer on behalf of an employee during a taxable year of the employer which ends within or with a taxable year of the trust for the trust which is not exempt under section 165 (a), shall be included in income of the employee for his taxable year during which the contribution is made if the employee's beneficial interest in the contribution is nonforfeitable at the time the contribution is made. The employee's beneficial interest in the contribution is nonforfeitable within the meaning of sections 165 (c) and 23 (p) if (1) the contribution is made if there is no contingency under the plan which may cause the employee to lose his rights in the contribution. For example, if under the terms of a pension plan, an employee upon termination of his services prior to a retirement date, whether voluntarily or involuntarily, is entitled to a deferred annuity contract to be purchased with the employer's contributions made on his behalf, or if the employer is obligated to make the contributions, the employee's beneficial interest in such contributions is nonforfeitable. On the other hand, if, under the terms of a pension plan, an employee will lose the right to any annuity purchased from, or to be provided by, contributions made by the employer if his services should be terminated prior to retirement, his beneficial interest in such contributions is forfeitable. The mere fact that an employee may be able to recover some share of the contributions, the employer's contributions are forfeitable. If the employer's contributions have been irrevocably applied to purchase an annuity contract for the employee, only a taxation of the trustee's contributions to provide an annuity for the employee provided only that the employee is alive on the dates the annuity payments are due, the employee's rights in the employer's contributions are nonforfeitable.

Sec. 166. REVOCABLE TRUSTS. Where at any time the power to re vest in the grantor title to any part of the corpus of the trust is vested in the grantor, (1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or (2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, then the income of such part of the corpus, the trust shall be included in computing the net income of the grantor.

§ 29.166–1 Trusts with respect to the corpus of the trust of which the grantor is regarded as remaining in substance the owner—(a) Scope. If the grantor of a trust is regarded, within the meaning of the Internal Revenue Code, as remaining in substance the owner of the corpus thereof, the income therefrom is not taxable in accordance with the provisions of sections 161, 162, 163, 165 (a), 166, 167, and 168. Such income, if nonforfeitable at the time the contribution is made, shall be included in the income of the grantor, except as provided in sections 22 (l) and 171. This section deals with the taxation of such income. As used in this section, the term "corpus" means any part or the whole of the property, real or personal, constituting the subject matter of the trust.

(b) Test of taxability to grantor. Section 166 covers with particular instances in which the grantor is regarded as in substance the owner of the corpus by reason of the fact that he has retained power to re vest the corpus in himself. For the purposes of this section the grantor is deemed to have retained such power if he, or any person not having a substantial interest in the corpus or the income therefrom adverse to the grantor, or both, own the corpus or the income therefrom in accordance with the provisions of sections 22 (l) and 171 regardless of:

(1) Whether such power or ability to re vest the trust corpus to the grantor's own use is effected by means of a power to revoke, to terminate, to alter or amend, or to appoint;

(2) Whether the exercise of such power is conditioned on the precedent giving of notice, or on the elapsing of a period of years, or on the happening of a specified event;

(3) The time at which the title to the corpus will re vest in the grantor in possession and enjoyment, whether such time is within the taxable year or not, or whether such time be fixed, determinable, or certain to come;

(4) Whether the power to re vest in the grantor title to the corpus is in the grantor, or in any person not having a substantial interest in the corpus or income therefrom adverse to the grantor, or in both;

(5) When the trust was created.

But the provisions of section 166 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Internal Revenue Code, similarly regarded as remaining in substance the owner of the corpus. The grantor is regarded as in substance the owner of the corpus, if, in view of the essential nature and purpose of the trust, it is apparent that, if upon the has failed to part permanently and definitively with the substantial incidents of ownership in the corpus.

In determining whether the grantor is in substance the owner of the corpus, the Internal Revenue Code has its own standard, which is a substantial one, dependent neither on the niceties of the particular conveyancing device used nor on the technical description which the law of property gives to the estate or interest transferred to the trustees or beneficiaries of the trust. In that determination, among the material factors are: (a) the fact that the corpus is or may be returned to the grantor after a specific term; the fact that the corpus is or may be administered in the interest of the grantor; the fact that the anticipated future income is being appropriated for the customary expenditures of the grantor or those which he would ordinarily and naturally make; and any other circumstance bearing on the grantor's enjoyment of the ownership of the corpus or some part of the corpus with which the grantor has parted with the substantial incidents of ownership in the corpus.

Thus, the grantor is regarded as being in substance the owner of the corpus if, in any event, the trust property is to be more than an arrangement whereby the grantor, in the ordering of his affairs, finds it expedient to entrust for a period the title to, and custody or management of certain of his property to a trustee, the income from such property to be used by the trustee during such period to make those expenditures which the grantor would customarily or naturally make and to which the grantor chooses to commit himself in advance, while the corpus is to be held intact, for return in due course to the grantor or to his personal representives. In such a case it is obvious that, at the time of the creation of the trust, an irrevocable disposition or consummated gift was made of those property rights which consist of the right to the expected future income of the corpus for the specified period. On the other hand, if, the grantor, incident to a definitive and permanent disposition of certain of his property, creates the trust in such a manner that, at any time prior to the revocation of the trust, the grantor revokes the transfer and the trust property is once more to re vest in the grantor in possession and enjoyment of:

(A) For the term of a year and a day, then to be distributed to whomever the wife of the grantor shall by deed appoint (the wife not having a substantial adverse interest in the disposition of the corpus or the income therefrom); or

(B) For the term of the grantor's life, then to be distributed to whomever the grantor shall by deed appoint, and revoke any provision of the trust instrument upon notice of a specified event;

In these typical cases the grantor is regarded as having retained the substantial incidents of ownership with respect to the income-producing property since the corpus will or may once more re vest in himself in (A) upon the expiration of the stated period if the grantor does not exercise his option to extend the trust, in (B) upon the revocation of the trust or upon the revocation of the trust instrument or an alteration or

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Example. A grantor is regarded as remaining in substance the owner of the corpus of the trust, if he has placed it in trust for his son, John.

(a) For the term of three years, at the end of which time the trust might be extended for a like period at the option of the grantor and successors thereafter, but in the absence of such option, the corpus would remain subject to re vest in the grantor. In such a case (A) or (B) above would be applicable.

(b) For the term of a year and a day, then to be distributed to whomever the wife of the grantor shall by deed appoint (the wife not having a substantial adverse interest in the disposition of the corpus or the income therefrom): or

(C) For the term of the grantor's life, then to be distributed to whomever the grantor shall by deed appoint, and revoke any provision of the trust instrument upon notice of a specified event;

In these typical cases the grantor is regarded as having retained the substantial incidents of ownership with respect to the income-producing property since the corpus will or may once more re vest in himself in (A) upon the expiration of the stated period if the grantor does not exercise his option to extend the trust, in (B) upon the revocation of the trust or upon the revocation of the trust instrument or an alteration or
amendment thereof, resulting in the designation of the grantor as distributee. If, however, the grantor strips himself of the substantial incidents or attributes of ownership in the corpus retained by him so that he ceases to be regarded as in substance the owner of the corpus, the income thereof realized after the effective date of such divesting is not taxable to the grantor but is taxable as provided in sections 161, 162, and 163.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the corpus in question, and the net income of the grantor only the income of such part.

(c) Income and deductions. If the grantor is regarded as remaining in substance the owner of the corpus, except as provided in sections 22 (k), 23 (u), and 171, the gross income of such corpus shall be included in the gross income of the grantor, and he shall be allowed those deductions which would have been allowed to him had the trust not been created.

SEC. 167. Income for benefit of grantor. (a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of only part of the corpus in question, be held, or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance in the nature of alimony or maintenance and support, or otherwise, for the purposes of the Internal Revenue Code).

when such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question."

§ 29.167-1 Trusts in the income of which the grantor retains an interest— (a) Scope. Section 167 prescribes that the income, or any part of the income, of certain trusts shall be taxed to the grantor, notwithstanding the retention by the grantor of a substantial interest in the corpus of the trust (as in section 169), but because of his retention of a certain interest in the corpus of the trust (as in section 169), but because of his retention of a certain interest in the income of the trust. This section deals with the taxation of such income. The term "income", as used in this section, means any part or the whole of the income of the trust.

(b) Test of taxability to the grantor. The test prescribed by the Internal Revenue Code as to the taxability of the grantor's retained interest in the trust income, resulting in the taxation of such income to the grantor, is whether he has failed to divest himself, permanently and definitely, of every right which might, by any possibility, enable him to have, control, dispose of, or to the extent of, income distributed to him, either actually or constructively. Such a distribution to the grantor occurs within the meaning of section 167 if the income is paid to him or to another (except where it is paid to a former wife) whether by order of the court, or done in obedience to his direction or if the income is applied in payment of premiums upon policies of insurance on the grantor's life.

For the purposes of this section, the sufficiency of the grantor's retained interest in the income in question is, or may at some future time be, vested in any person (either alone or in conjunction with the grantor) not having a substantial adverse interest in the income adverse to the grantor. A bare legal interest, such as that of a trustee, is never substantial and never adverse.

If the grantor has retained any such interest in the income, such income is taxable to the grantor (except as provided in section 22 (k) or 171) regardless of:

(1) Whether it may be distributed currently or accumulated for future distribution;

(2) Whether such distribution, either currently or subject to accumulation, is fixed by the trust instrument or is dependent on an exercise of discretion;

(3) Whether, if such distribution is in any way affected by or dependent on the occurrence of an event in the future, the discretion is the grantor or a person not having a substantial interest in the income adverse to the grantor, or both;

(4) The time or times of such distribution, whether within or without the taxable period, whether conditioned on the occurrence of an event in the future time of, or on the happening of a specified event, or otherwise.

(5) When the trust was created.

Thus, the inclusion of any trust within the scope of section 167 is based on the fact that the grantor has retained an interest in the income therefrom by which he is, or may be enabled at some time, to receive its benefits. But the provisions of section 167 are not to be regarded as excluding from taxation the income of a trust to which the grantor is entitled, in whole or in part, as an income beneficiary, whether or not the trust is revocable to the grantor, as a beneficiary.

(d) Credit for partially exempt interest. The proportionate share of the ordinary net income and of the ordinary net loss of the common trust fund, computed as provided in subsection (d), shall be allowed as a credit against the tax the beneficial owner of the trust fund is subject to. No credit shall be allowed for the excess of the ordinary net income or the ordinary net loss of the common trust fund, computed as provided in subsection (d), over the income or the loss of the trust fund the owner of which is not an individual, or over the income or the loss of the trust fund the owner of which is an individual.

(e) Income and deductions. If, as to any of the income, the test of taxability to the grantor is satisfied, such income shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to such income as he would have been entitled to had such income been distributable currently to him.

The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States, if allowed as credit against the tax imposed under this chapter, shall be allowed as credit against the tax the beneficial owner of such trust fund is subject to. Any excess of the ordinary net income or the ordinary net loss of the common trust fund, computed as provided in subsection (d), over the ordinary net income of the trust fund the owner of which is an individual, shall be considered as having been received by such participant in the common trust fund, and shall be allowed as a credit against the tax the owner of such trust fund is subject to.

Credit forPartially Exempt Interest. The proportionate share of the ordinary net income and ordinary net loss of the common trust fund, computed as provided in subsection (d), shall be allowed as a credit against the tax the beneficial owner of such trust fund is subject to. No credit shall be allowed for the excess of the ordinary net income or the ordinary net loss of the common trust fund, computed as provided in subsection (d), over the income or the loss of the trust fund the owner of which is not an individual, or over the income or the loss of the trust fund the owner of which is an individual.

The term "fund" means a fund maintained for the purposes of this Supplement for the benefits of a participant in the common trust fund for the purposes of the Federal Reserve System pertaining to the collective investment of trust funds by national banks.

(b) Transfers of common trust funds. A common trust fund shall not be subject to taxation under this chapter, subchapters A or B of chapter 2, or section 166 or 168 of the Revenue Act of 1935, 49 Stat. 1017, 1019, or chapter 6 and for the purposes of such chapters and subchapters shall not be considered a corporation.

The term "trust funds" means a fund maintained for the purposes of the Internal Revenue Code.
Computation of common trust fund income. The income of the common trust fund shall be computed in the same manner and on the same basis as in the case of a trust fund. The determination of such income shall be computed-

1. There shall be segregated the gains and losses from sales or exchanges of capital assets; or
2. After excluding all items of gain and loss from sales or exchanges of capital assets, there shall be computed-
   a. An ordinary net income which shall consist of the excess of the gross income over deductions; or
   b. An ordinary net loss which shall consist of the excess of the deductions over the gross income;
3. The so-called "charitable contribution" deduction allowed by section 23 (c) shall not be allowed.
4. Admission and withdrawal. No gain or loss shall be allowed from the common trust fund by the admission or withdrawal of a participant. The withdrawal of any participating interest by any participant shall be treated as a sale or exchange of such interest by the participant.
5. Returns by bank. Every bank (as defined in section 160) maintaining a common trust fund shall make a return under oath in conformity with the rules and regulations prescribed by the Board of Governors of the Federal Reserve System, and in accordance with the written plan under which the common trust fund is established and administered, provided such method clearly reflects the income of each participant.

§ 29.169-2 Income of participants in common trust fund. (a) Each participant in a common trust fund is required to include in computing its net income for its taxable year within which or with which the taxable year of the fund ends, whether or not distributed and whether or not distributable:

1. Its proportionate share of the gains and losses from sales or exchanges of capital assets held for not more than six months, computed as provided in § 29.163-3, as part of its gains and losses from sales or exchanges of capital assets held for not more than six months.
2. Its proportionate share of the ordinary net income or the ordinary net loss of the common trust fund, computed as provided in § 29.169-1.
3. Its proportionate share of the long-term capital income or the long-term capital loss, computed as provided in § 29.169-3.

(b) Each participant’s proportionate share in the amount of income specified in section 25 (a) received by the common trust fund shall be deemed to have been received by such participant as such interest. (For reduction of credit for such interest on account of amortizable bond premium, see § 29.162-3.) For the purposes of the Internal Revenue Code, any tax withheld at the source from income of the fund shall be deemed to have been withheld proportionately from the participants to whom such income is allocated.

(c) The proportionate share of each participant in the gains and losses from sales or exchanges of capital assets held for not more than six months, gains and losses from sales or exchanges of capital assets held for more than six months, the ordinary net income or ordinary net loss, the partially exempt interest, and the tax withheld at the source shall be determined in accordance with the method of accounting adopted by the bank in accordance with the written plan under which the common trust fund is established and administered, provided such method clearly reflects the income of each participant.

The items of income and deductions are, therefore, to be allocated to the periods between valuation dates within the taxable year, regardless of whether the common trust fund is treated as a sale or exchange of capital assets held for not more than six months, and gains and losses from sales or exchanges of capital assets held for more than six months are computed for each such period.

The proportionate shares of the participants in such items are then to be determined. The provisions of this paragraph may be illustrated by the following example:

Example. The plan of a common trust fund provides for quarterly valuation dates and for the computation and the distribution of the income upon a quarterly basis, except that there shall be no distribution of capital gains. The participants are as follows: Trusts A, B, C, and D for the first quarter; Trusts A, B, C, and E for the second quarter; Trusts A, B, E, and G for the third and fourth quarters, the participants having equal participating interests. As computed upon the quarterly basis, the ordinary net income, the short-term capital gain, and the long-term capital loss for the taxable year were as follows:

<table>
<thead>
<tr>
<th>Participant</th>
<th>First Quarter</th>
<th>Second Quarter</th>
<th>Third Quarter</th>
<th>Fourth Quarter</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>25</td>
<td>25</td>
<td>25</td>
<td>25</td>
<td>100</td>
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<tr>
<td>B</td>
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<td>C</td>
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<td>D</td>
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<td>25</td>
<td>100</td>
</tr>
</tbody>
</table>

The participants’ shares of ordinary net income are as follows:

<table>
<thead>
<tr>
<th>Participant</th>
<th>First Quarter</th>
<th>Second Quarter</th>
<th>Third Quarter</th>
<th>Fourth Quarter</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>25</td>
<td>25</td>
<td>25</td>
<td>25</td>
<td>100</td>
</tr>
<tr>
<td>B</td>
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<td>C</td>
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<td>D</td>
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<td>25</td>
<td>100</td>
</tr>
</tbody>
</table>

The participants’ shares of the short-term capital gain are as follows:

<table>
<thead>
<tr>
<th>Participant</th>
<th>First Quarter</th>
<th>Second Quarter</th>
<th>Third Quarter</th>
<th>Fourth Quarter</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>25</td>
<td>25</td>
<td>25</td>
<td>25</td>
<td>100</td>
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<tr>
<td>B</td>
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<tr>
<td>C</td>
<td>25</td>
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<td>D</td>
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<td>25</td>
<td>25</td>
<td>100</td>
</tr>
</tbody>
</table>

The participants’ shares of the long-term capital loss are as follows:

<table>
<thead>
<tr>
<th>Participant</th>
<th>First Quarter</th>
<th>Second Quarter</th>
<th>Third Quarter</th>
<th>Fourth Quarter</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>25</td>
<td>25</td>
<td>25</td>
<td>25</td>
<td>100</td>
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<tr>
<td>B</td>
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<td>C</td>
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<td>D</td>
<td>25</td>
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<td>25</td>
<td>25</td>
<td>100</td>
</tr>
</tbody>
</table>

If in the above example the common trust fund also had short-term capital losses and long-term capital gains, the treatment of such gains or losses would be similar to that accorded to the short-term capital gains and long-term capital losses in the above example.

(d) The provisions of sections 161, 162, 165, and 167 are applicable in deter-
ming the extent to which each participant's proportionate share of the income of the common trust fund is taxable to the participant, or to the beneficiaries or the grantor of the participant.

§ 29.169-3 Computation of common trust fund income. The net income of the common trust fund shall be computed in the same manner and on the same basis as the net income of the grantor of the trust fund

(a) Gain or loss. The common trust fund realizes no gain or loss by the

(b) The gain or losses from sales or exchanges of capital assets of the common trust fund are required to be segregated. A common trust fund is not allowed the benefit of the capital loss carry-over provided by section 117 (c). the ordinary net income, that is, the excess of the gross income over the deductions, or the ordinary net loss, that is, the excess of the deductions over the gross income, shall be computed after excluding gains and losses from sales or exchanges of capital assets.

§ 29.169-4 Admission and withdrawal of participating interest in common trust fund—(a) Gain or loss. The common trust fund realizes no gain or loss by the admission or withdrawal of a participant, and the basis of the assets and the period for which the participant held the common trust fund for the purposes of section 117 (b) are unaffected by such admission or withdrawal. If a participant withdraws the whole or any part of its participating interest from the common trust fund, such withdrawal shall be treated as a sale or exchange by the participant of the participating interest or portion thereof which is so withdrawn. A participant is not deemed to have withdrawn any part of its participating interest in the common trust fund so as to have completed a closed transaction for the purposes of section 117 (b) if a subordinate to the participant

(b) The gain or losses upon withdrawal of a participating interest or portion thereof shall be the money contributed by the participant to the common trust fund to acquire the participating interest or portion thereof withdrawn. Such basis shall not be reduced on account of the segregation of any investment in the common trust fund pursuant to section 166 of this title or the provisions of 12 CFR 206.17 (c) (7). For the purpose of making the adjustments, additions, and reductions with respect to basis as prescribed in this paragraph, the ward, rather than the guardian, shall be deemed to be the participant; and the grantor, rather than the trust to the extent that the income of the trust is taxable to the grantor pursuant to the provisions of section 166 or 167, shall be deemed to be the participant.

(c) Additions to basis. As prescribed in paragraph (b) of this section, in computing the gain or loss upon withdrawal of a participating interest or portion thereof, there shall be added to the basis of the participating interest or portion thereof withdrawn an amount equal to the aggregate of the following items, to the extent that they were properly allocated to the participant for a taxable year of the common trust fund, and were not distributed to the participant prior to withdrawal:

(1) Wholly exempt income of the common trust fund for any taxable year.

(2) Net income of the common trust fund for the taxable years beginning after December 31, 1935, and prior to January 1, 1938.

(3) Net short-term capital gain of the common trust fund for each taxable year beginning after December 31, 1937.

(4) The excess of the gains over the losses recognized to the common trust fund for each taxable year beginning after December 31, 1937, by the participant's name and address, the ordinary net income, and its proportionate share of gains and losses from sales or exchanges of capital assets. See § 29.169-2. A copy of the common trust fund must be filed with the return. If, however, a copy of such plan has once been filed with a return, it need not again be filed if the agreement includes a statement showing when and where it was filed. If the plan is amended in any way after such copy has been filed, a copy of the amendment must be filed with the return for the taxable year in which the amendment was made. Each such return shall be sworn to in the same manner as the return filed by the bank under section 82.

§ 29.170-1 Net operating losses — (a) Estates and trusts. The net operating loss deduction allowed by section 23 (b) is not allowed to estates and trusts for the purposes of section 165 may not be used in the computation of the net operating loss carry-over.

(b) Common trust funds. The net operating loss deduction is not allowed to a common trust fund. Each participant in a common trust fund, however, will be allowed the benefits of such deduction.
In the computation of such deduction a participant in a common trust fund shall take into account its pro rata share of the income and losses of the common trust fund as prescribed by § 29.171-1 in the case of a common trust fund in existence on December 31, 1941.

**Sec. 171. Income of an estate or trust in case of divorce, etc.** [As added by sec. 120 (c), Rev. Act 1942]

(a) Income of gross income. There shall be included in the gross income of a wife who is divorced or legally separated under a decree of divorce or separate maintenance as the amount of the income of any trust such wife is entitled to receive and which, except for the provisions of this section, would be includible in the gross income of her husband, and such amount shall not, despite section 168, section 167, or any other provision of this chapter, be includible in the gross income of such husband. This subsection shall not apply to that part of any such income included in the gross income of the spouse in discharge of his alimony obligation. Furthermore, section 22 shall not apply to that part of any such income included in the gross income of the spouses who are divorced or legally separated under a decree of divorce or of separate maintenance, where under prior law the husband was taxable to the wife in such cases, the income of a so-called alimony trust would be taxable to the husband because of his retention of control over the income or trust corpus. Section 171 (a), the income of a so-called alimony trust is taxable to the former wife because of the termination of the husband's obligation.

(b) Wife considered a beneficiary. For the purposes of computing the net income of the estate or trust, any and all income in the wife described in section 22 (c) or subsection (a) of this section, such wife shall be considered as the beneficiary specified in this supplement. A periodic payment under section 22 (c) to any part of which the provisions of this supplement are applicable shall be included in the gross income of the beneficiary in the taxable year in which under this supplement such part is required to be included. (Note: Under subsection (g) of the Revenue Act of 1942 section 171 is applicable "only with respect to taxable years beginning after December 31, 1941; except that if the first taxable year beginning after December 31, 1941, of the husband does not begin on the same day as the first taxable year beginning after December 31, 1941, of the wife, such amendments shall first become applicable in the case of the husband on the first day of the taxable year beginning after December 31, 1941, regardless of the taxable year of the husband in which such day falls.")

§ 23.171-1 Income of trust in case of divorce, etc.—In general. Section 171 (a) provides rules in certain cases of the taxability of income of trusts as between spouses who are divorced or legally separated under a court order or decree. In such cases, the spouse actually entitled to receive payments from the trust is considered the beneficiary rather than the spouse in discharge of whose obligation such payments are made. For convenience, beneficiary spouses are discussed hereafter in this section and in § 23.171-2 be referred to as the "wife" and the obligor spouse from whom she is divorced or legally separated as the "husband." (See section 23.171 (a) (1).) Thus, under section 171 (a) income of a trust:

(1) Which is paid, credited or to be distributed to the wife in a taxable year of the wife, and

(a) except for the provisions of section 171, would be includible in the gross income of her husband, shall be includible in her gross income and shall not be includible in his gross income.

Section 171 (a) does not apply in any case to which section 22 (c) applies. Alternatively section 22 (k) is seemingly cover some of the same situations, there are important differences between them. Thus, section 171 (a) applies, for example, without a trust created before the divorce or separation and not in contemplation of it, while section 22 (k) applies only if the creation of the trust or payments by a previously created trust are in discharge of his alimony obligation and imposed upon or assumed by the husband (or made specific) under the court decree or an instrument incident to the divorce or legal separation. On the other hand, where under prior law the husband was taxable to the wife's income of the full amount of periodic payments received attributable to property in trust (whether or not out of trust income), while section 171 (a) requires the income to be distributed to her to be included only to the extent such amounts are out of income of the trust for its taxable year (determined as specified in section 102).

Section 171 (a) is designed to produce uniformity as between cases described in section 171 (a) and cases described in section 171 (a), where, in the former cases, without section 171 (a), the income of a so-called alimony trust would be taxable to the husband because of his continuing obligation to support his former wife, and where, in the latter cases, the income of a legal obligation trust is taxable to the former wife because of the termination of the husband's obligation. Furthermore, section 171 (a) taxes trust income to the wife in all cases where the husband would be taxed not only because of the discharge of his alimony obligation but also because of his retention of control over the income or trust corpus. Section 171 (a) applies not to the extent such amounts are out of income of the trust for its taxable year (determined as specified in section 102).

The application of section 171 (a) may be illustrated by the following example, in which it is assumed that both the husband and wife make their income tax returns on a calendar year basis:

**Example (1).** Upon the marriage of H and W, H irrevocably transfers property in trust to receive the income from W for her life for support, maintenance, and all other expenses. Some years later, W obtains a legal separation from H and, in conformity with the terms of the separation, relying upon the income from the trust payable to her, does not file any return for the support period. The court, however, has jurisdiction under the law of the State to order at any time prior to an absolute divorce that provision be made by H for W's support. Under the provisions of section 171 (a), the income of the trust becomes payable to W after the order of separation is includible in her income and to the extent such income is includible in W's income or deductible by her.

**Example (2).** H transfers property in trust for the benefit of W, retaining the power to revoke the trust at any time. H, however, promises that if he revokes the trust he will transfer to W property in the value of $100,000. The transfer in trust and the agreement are not incident to the marriage for more than two years later W divorces H. The court decree is silent as to alimony and the trust. After the divorce, income of the trust which is payable to W taxable to her, and is not taxable to H or deductible by him. If H later terminates the trust and transfers the property to W, the $100,000 transfer to W is taxable to her, and is not taxable to H or deductible by him.

(b) Alimony trust income designated for support of minor children. Section 171 (a) does not require the inclusion in the wife's income of trust income which the terms of the decree or trust instrument fix in terms of an amount of money or a portion of such income as a sum which is payable for the support of minor children of the husband. The statute prescribes the treatment in cases where under the terms of the decree or trust instrument a specific amount of trust income is to be paid but a lesser amount is payable. In such cases, to the extent the sum which is payable for such support out of the originally specified amount of trust income, such trust income is considered payable for such support. The rule is similar to that provided in the case of periodic payments under section 22 (c). See § 29.22 (c)–1 (d).

§ 29.171–2 Application of trust rules to alimony payments. For the purpose of the application of sections 162, 163, and 164, if the wife described in section 171 or section 22 (c) is entitled to receive payments attributable to property in trust considered a beneficiary of the trust, whether or not the payments are made for the benefit of the husband in discharge of his obligations.

A periodic payment included in the wife's gross income under section 22 (c) attributable to property in trust shall be included in full in her gross income in her taxable year in which any part is required to be included under sections 162 and 164. Assume, for example, in a case in which both the wife and the trust file separate tax returns on the calendar year basis, that an annuity of $5,600 is to be paid to the wife by the trustee every December 31 (out of trust income if possible and, if not, out of corpus) pursuant to the terms of a divorce decree. Of the $5,600 distributable on December 31, 1942, $4,600 is payable out of income and $1,000 out of corpus. The actual distribution is made in 1943. Although the periodic payment is received by the wife in 1942, since under sections 162 and 164 the $4,600 income distributable on December 31, 1942, is to be included in the wife's income in the taxable year, the $1,000 payment out of corpus is to be included in her income for 1942.
PARTNERSHIPS

Sec. 181. Partnership not taxable.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

Sec. 182. Tax of partners [as amended by sec. 150 (g), Rev. Act 1943].

In computing the net income of each partner, he shall include, whether or not a distribution is made to him:

(a) As part of his gains and losses from sales or exchanges of capital assets held for not more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for not more than 6 months.

(b) As part of his gains and losses from sales or exchanges of capital assets held for not more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for more than 6 months.

(c) His distributive share of the ordinary net income or net loss of the partnership, computed as provided in section 183 (b).

Sec. 183-1 Distributive share of partners. (a) Each partner is required to include in his return for his taxable year, within which or with which the taxable year of the partnership ends, whether or not distributed:

(1) As part of his gains and losses from sales or exchanges of capital assets held for not more than six months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for not more than six months.

(2) As part of his gains and losses from sales or exchanges of capital assets held for more than six months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for more than six months.

(3) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

(b) If separate returns are made by the husband and wife domiciled in a community property State, and the husband only is a member of a partnership, the part of his distributive share of gains and losses of the partnership from sales or exchanges of capital assets or the part of his distributive share of ordinary net income or ordinary net loss, which is, or is derived from, the proceeds of an emergency facility, as defined in section 124 (t), acquired or completed after December 31, 1939, such estate or trust is entitled to make returns of income.

In the case of a partnership closely related to any trade or business or the earnings of which are derived, in whole or in part, from sales or exchanges of capital assets, the partner shall be liable for income tax only for his distributive share of the ordinary net income of the partnership, as defined in section 124 and thereunder. The principles governing the apportionment of depreciation in the case of property held in trust are applicable with respect to the amortization of an emergency facility of an estate or trust. See section 124 (t) and section 124 and the regulations thereunder.

The governing body of an emergency facility of a partnership shall be required to make returns of income.

Sec. 183 Computation of partnership income. (a) General rule. The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual except as provided in subsections (b) and (c).

(1) Capital gains and losses. There shall be segregated the gains and losses from sales or exchanges of capital assets.

(2) Ordinary net income or loss. After excluding all items of gain and loss from sales or exchanges of capital assets, there shall be computed:-(a) An ordinary net income which shall consist of the excess of the gross income over the deductions; or

(b) An ordinary net loss which shall consist of the excess of the deductions over the gross income.

(c) Charitable contributions. In computing the net income of the partnership, the so-called "charitable contribution" deduction allowed by section 23 (o) shall not be allowed; but each partner shall be considered as having made payment, within his taxable year, of his distributive portion of any contribution or gift, payment of which was made to a charitable organization, without regard to the taxable year, of the character which would be allowed to the partnership as a deduction under such section if this subsection had not been enacted.

Sec. 183-1 Computation of partnership income. The net income of the partnership shall be computed in the same manner and on the same basis as the net income of an individual, except that:

(a) The partnership is required to segregate its gains and losses from sales or exchanges of capital assets. A partnership is not allowed the benefit of section 117 (c).

(b) The partnership is further required, after excluding all items described in paragraph (a), to compute (1) an ordinary net income which consists of the excess of gross income over the deductions, or (2) an ordinary net loss which consists of the excess of the deductions over gross income.

In the computation of the ordinary net income or ordinary net loss, the partnership is denied the so-called charitable contribution deduction allowed by section 23 (o), but each partner is considered as having made payment, within his taxable year, of his distributive portion of any contribution or gift, payment of which was made to a charitable organization, without regard to the taxable year of the character which would be allowed to the partnership as a deduction if section 183 (o) had not been enacted. Payments made to a partner for services rendered and for interest on capital contributions are not deductible in computing the net income of the partnership, such payments being held to represent a division of partnership profits.

Sec. 184. Credits against net income [as amended by sec. 162 (f), Rev. Act 1943].

The partner shall, for the purpose of the normal tax to be allowed him on his share of his net income, in addition to the credits allowed to him under section 25, his proportionate share of the credits allowed to the partnership, hold to the extent of interest specified in section 25 (a) as are received by the partnership. If the partnership elects under section 122 to treat the premium on bonds, the interest on which is allowable as a credit under section 25 (a) (1) or (3), as amortizable, for the purpose of the provision reciting the partner's proportionate share of the interest received by the partnership shall be his proportionate share of interest (determined without regard to this sentence) reduced by so much of the deduction under section 25 (v) as is attributable to such share.

Sec. 185. Earned income.

In the case of the members of a partnership the proper part of each share of the net income which consists of earned income shall be determined under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary and shall be separately shown in the return of the partnership.

Sec. 185-1 Earned income credit of partners. For the purpose of computing the earned income credit as provided in section 25 (a) (3) and (4), a member of a partnership is entitled to treat a proper part of his distributive share of the partnership net income as earned income. Such part cannot exceed a reasonable allowance as compensation for personal services actually rendered by the partner in connection with the partnership business. In the case of a partnership which is engaged in a trade or business in which capital is a material income-producing factor and in the trade or business of which the partner renders personal services which are material to the earning of the partnership income, the earned income of the partner from the partnership is a reasonable allowance as compensation for personal services actually rendered by him, but not in excess of 20 percent of his share of the net profits of the partnership (computed without deduction for so-called salaries to members). In such a case, if reasonable compensation is less than 20 percent of the partner's share of the net profits, the earned income is the full amount of the reasonable compensation,
but, if reasonable compensation is more than 20 percent of the partner's share of the net profits or losses, then 20 percent is 20 percent of the partner's share of such profits.

There must be included in the return of the partnership a statement showing the name of the partner, the amount (determined in accordance with the first paragraph of this section) of the partner's distributive share of the partnership net income which consists of earned income.

Example. A partnership composed of A, B, and C is engaged in the retail men's clothing business. Each partner is entitled to one-third of the net profits, after deduction of so-called salaries to members. A devotes most of his time to the business and is paid a salary of $10,000. B devotes half of his time to the business and is paid a salary of $5,000. C devotes none of his time to the business and receives no salary. The net profits of the partnership for the taxable year, computed without deduction for so-called salaries to members, are $82,000. The earned income of the partner A in the partnership is as follows: Although A received a salary of $10,000 and B a salary of $5,000, since the partnership is engaged in "business," and therefore, is a material income-producing factor, the earned income of each from the partnership is limited to 20 percent of his share of the net profits. Thus, A's earned income is $10,000 ($10,000 salary + $3,000 (1/3 of net profits after deduction of $10,000 salary) = $13,000). Twenty-five percent of $13,000, or $3,250, is A's earned income from the partnership of $4,500. Since B's share of the net profits is $5,000, and there is $10,000 in net profits, B is earned income of the partnership is limited to $5,000. Twenty-five percent of $5,000, or $1,250, is B's earned income from the partnership. C has no earned income from the partnership, since he renders no personal service in connection with the partnership business.

Sec. 186. Taxes of foreign countries and possessions of United States. The amount of income, war-profits, and excess profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax of the member of a partnership to the extent provided in section 101.

Sec. 187. Partnership returns. Every partnership shall make a return for each taxable year, stating specifically the items of income and the deductions allowed by this chapter and such other information as the Commissioner will prescribe by regulations, and shall include in the return the names and addresses of the individuals who shall 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.

§ 29.187-1 Partnership returns. Every partnership shall make a return of income, regardless of the amount of its net income (see section 3171 (a) (2), defining partnership). The return shall be on Form 1065; shall state specifically the information required to be stated by the return form; shall be filled in according to the instructions contained in the form, and issued with respect thereto; 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 (whether or not a calendar year, as the case may be), irrespective of the taxable years of the partners. (See sections 182 and 183.) If the partnership makes any change in its accounting period, it shall make its return in accordance with the provisions of section 47, except that the return shall not be placed on an annual basis under section 47 (c).

Sec. 188. Different taxable years of partners and partnership. If the taxable year of a partner is different from that of the partnership, the inclusions with respect to the net income of the partnership in computing the income of the partner for his taxable year, shall be based upon the net income of the partnership for any taxable year of the partnership (whether beginning on, before, or after January 1, 1939) ending within or with the taxable year of the partner.

Sec. 189. Net operating loss deduction in case of partners. The benefit of the deduction for net operating losses provided by section 23 (d) shall not be allowed to a partnership but shall be allowed to the members of the partnership under regulations prescribed by the Commissioner with the approval of the Secretary.

§ 29.189-1 Net operating loss deduction in case of partners. The benefit of the deduction for net operating losses provided by section 23 (d) shall be allowed to a partner as an ordinary business deduction.

Item losses and gains. The partnership's business gains and losses shall be included by each partner as business gains and losses from such sales or exchanges and the partner's distributive share of such business gains and losses shall be included by each partner as business ordinary gains and losses from sales or exchanges of capital assets held for more than six months, respectively.

(a) Exclusions and limitations applicable in computation of partner's net operating loss. The partnership's gains and losses from sales or exchanges of capital assets held for not more than six months and the partnership's nonbusiness gains and losses from sales or exchanges of capital assets held for not more than six months, respectively.

(b) Business ordinary net income or loss. After excluding all items required to be segregated by (1) and (2) above, there shall be computed:

(c) A business ordinary net income of the partnership, which shall consist of the excess of the business gross income over the business deductions; and

(d) A business ordinary net loss of the partnership, which shall consist of the excess of the business gross losses over the business deductions.

In making the above computations the limitations and exceptions provided by sections 122 (d) (1) and (2) shall be applied.

His distributive share of a business ordinary net income or loss of the partnership shall be included by each partner as an ordinary business gross income, and of a business ordinary net loss of the partnership, which shall consist of the excess of the nonbusiness deductions over the nonbusiness gross income.

(1) The ordinary net income or ordinary net loss of the partnership shall be included with the business ordinary gross income, under the regulations thereunder. Amortization deductions with respect thereto shall be allowed to the members of a partnership but shall be allowed to the partnership in the same manner and to the same extent as in the case of an individual.

(2) The allocations of amortization deductions with respect to an emergency facility of a partnership are not allowed to the members of the partnership.

(3) Ordinary net income or loss. After excluding all items required to be segregated by (1) and (2) above, there shall be computed:

(a) A business ordinary net income of the partnership, which shall consist of the excess of the business gross income over the business deductions; or

(b) A business ordinary net loss of the partnership, which shall consist of the excess of the business gross losses over the business deductions.

(c) A nonbusiness ordinary net income of the partnership, which shall consist of the excess of the nonbusiness gross income over the nonbusiness deductions; and

(d) A nonbusiness ordinary net loss of the partnership, which shall consist of the excess of the nonbusiness deductions over the nonbusiness gross income.

If the amount of the deduction allowed by paragraphs (1) and (2) is less than the excess of the nonbusiness deductions over the nonbusiness gross income, the partnership shall be allowed no additional deduction.

In the case of a partnership, the benefit of the deduction for net operating losses allowed by paragraphs (1) and (2) shall be allowed to the partnership, which shall consist of the excess of the nonbusiness deductions over the nonbusiness gross income.

Insurance companies. (See section 202. Life insurance companies [as amended by section 202, Rev. Act 1939; section 203 (a), Rev. Act 1942].

(3) Ordinary net income or loss. After excluding all items required to be segregated by (1) and (2) above, there shall be computed:

(a) A business ordinary net income of the partnership, which shall consist of the excess of the business gross income over the business deductions; or

(b) A business ordinary net loss of the partnership, which shall consist of the excess of the business gross losses over the business deductions.

(c) A nonbusiness ordinary net income of the partnership, which shall consist of the excess of the nonbusiness gross income over the nonbusiness deductions; and

(d) A nonbusiness ordinary net loss of the partnership, which shall consist of the excess of the nonbusiness deductions over the nonbusiness gross income.

If the amount of the deduction allowed by paragraphs (1) and (2) is less than the excess of the nonbusiness deductions over the nonbusiness gross income, the partnership shall be allowed no additional deduction.

In the case of a partnership, the benefit of the deduction for net operating losses allowed by paragraphs (1) and (2) shall be allowed to the partnership, which shall consist of the excess of the nonbusiness deductions over the nonbusiness gross income.

If the amount of the deduction allowed by paragraphs (1) and (2) is less than the excess of the nonbusiness deductions over the nonbusiness gross income, the partnership shall be allowed no additional deduction.

In the case of a partnership, the benefit of the deduction for net operating losses allowed by paragraphs (1) and (2) shall be allowed to the partnership, which shall consist of the excess of the nonbusiness deductions over the nonbusiness gross income.
and upon the adjusted corporation surtax net income (as defined in section 203) of every life insurance company which is engaged in the business of life insurance in such company on the form approved for life insurance companies by the National Association of Insurance Commissioners.

(b) Definition of life insurance company. When used in this chapter, the term "life insurance company" means a company which is engaged in the business of issuing life insurance and annuity contracts (either separate or combined with noncancellable health and accident insurance), or noncancellable contracts of health and accident insurance, and the life insurance reserves (as defined in subsection (c) (2)) plus unearned premiums and unpaid losses not included in life insurance reserves, and all other insurance reserves required by a tax act of the United States beginning after December 31, 1941, a burial or funeral benefit insurance company engaged directly in the manufacture of funeral supplies or funeral services shall not be taxable under this section but shall be taxable under section 204 or section 207.

(c) Other definitions. In the case of a life insurance company—

(1) Gross income. The term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents.

(2) Life insurance reserves. The term "life insurance reserves" means amounts which are computed or estimated on the basis of recognized mortality experience and which are stated to mature or liquidate, either by payment or reinsurance, future unaccrued claims arising from life insurance, annuity, and noncancellable health and accident insurance contracts (including life insurance or annuity contracts combined with noncancellable health and accident insurance) involving, at the time with respect to which the reserve is computed, no reasonable expectation of future premiums or other considerations, which are ascertainable in the case of policies providing life insurance, to recover the reserves required by the policy, within the United States if with respect to its United States business it would qualify as a life insurance company, shall be engaged directly in the manufacture of funeral supplies or funeral services.

(3) Adjusted reserves. The term "adjusted reserves" means life insurance reserves plus or minus the adjustments of such reserves as are computed on a pre-determined basis.

(4) Reserves earnings rate. The reserve earnings rate means a rate computed by adding 2.1125 per centum (65 per centum of 3.3 percent) of the average rate of interest assumed in computing life insurance reserves. Such average rate shall be calculated by multiplying each of the average earnings rates of the amounts of the adjusted reserves computed at that rate by the beginning and end of the taxable year and dividing the sum of the products of the mean of the total adjusted reserves at the beginning and end of the taxable year.

(5) Reserve for deferred dividends. The term "reserve for deferred dividends" means amounts received at the end of the taxable year as a reserve for dividends (other than dividends payable during the year following the taxable year) the payment of which is deferred for a period of years from the date of the policy contract.

(6) Interest paid. The term "interest paid" includes amounts paid to the shareholder, which are paid subject to the provisions of section 117 (capital gains and losses) nor to the provisions of section 125 (amortizable bond premiums). For computation of the adjusted normal-tax net income from (b) Tax-free interest. The amount of interest (as defined in section 22) received during the taxable year which under section 22 (b) (4) is excluded from gross income.

(2) Investment expenses. Investment expenses paid during the taxable year. If any general expenses are in part assigned to or included in the investment expenses, the total deduction allowed by subparagraph (A) shall not exceed one-fourth of one per centum of the mean of the book value of the invested assets existing at the beginning of the taxable year plus one-fourth of one per centum of the amount by which net income computed without any deduction for treatment expenses allowed by this subparagraph, or for tax-free interest allowed by subparagraph (B), exceeds 3½ per centum of the book value of the mean of the invested assets at the beginning and end of the taxable year.

(C) Real estate expenses. Taxes and other expenses (including mortgage interest) assessed or levied in the year against real estate owned by the company, not including taxes assessed against local benefits and assessed against real estate owned by the company, not including taxes assessed against local benefits of a kind tending to increase the value of the property assessed, and not including any amount paid out for new buildings, or for permanent improvements to a building, or for permanent improvement of the value of any property. The deduction allowed by this paragraph shall be allowed in the case of taxes imposed upon a shareholder who is also a shareholder, which are paid by the company without reimbursement from the shareholder, but in such cases no deduction shall be allowed for the amount of such taxes.

All provisions of the Internal Revenue Code and of these regulations not inconsistent with sections 201 to 203, inclusive, are applicable to the assessment and collection of the tax imposed by section 201 (a), and life insurance companies are subject to the same rates as are Corporations in case of returns and payment of income tax by other corporations. The return shall be on Form 1120L.

Foreign life insurance companies not carrying on an insurance business within the United States are not taxable under section 201 (a), but are taxable as other foreign corporations. See section 231.

§ 29.201–2 Foreign life insurance companies. A foreign life insurance company carrying on a life insurance business within the United States, if with respect to its United States business it would qualify as a life insurance company under section 201 (b), is taxable on its income received during the taxable year from sources within and without the United States, pertaining to its United States business. Such a company is taxable in the same manner as a domestic life insurance company except that the determinations necessary for the purposes of chapter 1, such as gross income, the adjustment for certain reserves, deductions, amortization of premiums and accrued discount and the credits provided on dans section 26, shall be made on the basis of the income disbursements, assets, and liabilities reported in the annual statement for the taxable year of the United States business of such company on the form approved for life insurance companies by the National Association of Life Insurance Commissioners. This statement is presumed clearly to reflect the income disbursements, assets, and liabilities of the United States business of the company and in so far as it is not inconsistent with the Internal Revenue Code will be recognized and used as a basis for that purpose.

§ 29.201–3 Life insurance companies: definition. The term “life insurance company” as used in chapter 1 is defined in section 201 (b). In determining whether an insurance company is a life insurance company the life insurance reserves (as defined in section 201 (c) (2)) plus any unearned premiums and unpaid losses from noncancelable life, health, or accident policies, not included in “life insurance reserves” must comprise more than 50 percent of its total reserves (as defined in section 201 (b) (2)). An insurance company writing only noncancelable life, health, or accident policies and having no “life insurance reserves” may qualify as a life insurance company if its unearned premiums and unpaid losses from such policies not included in more than 50 percent of its total reserves. A noncancelable insurance policy means a contract which the insurance company is under an obligation to renew or continue at a specified premium and with respect to which a reserve in addition to the unearned premium must be carried to cover that obligation. A burial or funeral benefit insurance company qualifying as a life insurance company that continues to be taxed under section 201 for taxable years beginning prior to January 1, 1944. For taxable years beginning after December 31, 1943, any such company engaged directly in the manufacture of funeral supplies or the performance of funeral services will be taxable under section 204 or section 207 as an insurance company other than life. For the definition of an insurance company see § 23.3707–7.

§ 29.201–4 Life insurance reserves. The term “life insurance reserves” is defined in section 201 (c) (2). Generally, such reserves, as in the case of level premium life insurance, are held to supplement the future premium receipts when the latter, alone, are insufficient to cover the increased risk in the later years. In the case of cancelable health and accident policies, such as cancelable contracts, the unearned premiums held to cover the risk for the unexpired period covered by the premiums are not included in life insurance reserves. Unpaid loss reserves from noncancelable health and accident policies are included in life insurance reserves if they are computed or estimated on the basis of recognized mortality or morbidity tables and assumed rates of interest.

In the case of an assessment life insurance company or association, life insurance reserves include sums actually deposited by such company or association with State or Territorial officers pursuant to law as guaranty or reserve funds, and any funds maintained under the charter or articles of incorporation or association of such company or association (or by the State insurance commissioner) of such company or association, exclusively for the payment of claims arising under certificates of membership or policies issued under the association plan and not subject to any other use.

Life insurance reserves, except as otherwise provided in section 201 (c) (2), must be held by law either by express statutory authority or by regulations of the insurance department of a State, Territory, or the District of Columbia when promulgated in the exercise of a power conferred by statute, but such requirement must not be conclusive; for example, life insurance reserves do not include reserves required to be maintained to provide for the ordinary running expenses of a business definite in amount, which are paid by every company from its income if its business is to continue, such as taxes, salaries, and unpaid brokerage; nor do they include the net value of risks reinsured on a policy basis. Liability for premiums paid in advance, liability for annual and deferred dividends declared or apportioned, liability for dividends paid on deposits at interest, liability for accrued but unsettled policy claims whether known or unreported, liability for supplementary contracts not involving, at the time of such contract, any liability on which the policy was based, and life, health, or accident contingencies.

In any case where reserves are claimed sufficient information must be filed with the return to enable the Commissioner to determine the validity of the reserve. Only reserves which are required by law or insurance department ruling, which are peculiar to insurance companies, and which are dependent upon interest earnings, or upon the maintenance, will, except as otherwise specifically provided in section 201(c) (2), be considered as life insurance reserves. A company is permitted to make use of the highest aggregate reserve required by any State or Territory or the District of Columbia in which it transacts business, but the reserve must have been actually held.

In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserve funds thereon be held upon recognized mortality or morbidity tables covering disability benefits of the kind contained in policies issued by this particular class of companies but they need not be required by law.

§ 29.201–5 Interest paid. Interest paid is one of the elements to be used, together with adjusted reserves, reserve earnings rate, and reserve for deferred dividends, in arriving at the figure to be determined and paid by the insurance company to every owner of life insurance in addition to the premium paid at the time of the policy. Dividends to be paid by the company to accumulate at interest are a debt and not a reserve liability. Amounts in the nature of interest include so-called excess-interest dividends as well as dividends paid into dividends reserves, and the interest and other liability credit provided in section 202 (b). Life insurance reserves as defined in § 29.201–4 are not indebtedness. Dividends left with the company to accumulate at interest are a debt and not a reserve liability. Amounts in the nature of interest include so-called excess-interest dividends as well as dividends paid into dividends reserves, and the interest and other liability credit provided in section 202 (b). Life insurance reserves as defined in § 29.201–4 are not indebtedness. Dividends left with the company to accumulate at interest are a debt and not a reserve liability. Amounts in the nature of interest include so-called excess-interest dividends as well as dividends paid into dividends reserves, and the interest and other liability credit provided in section 202 (b).
of payment and the full amount of the interest paid and not merely the guaranteed interest is considered as interest paid.

§ 29.201-6 Adjusted reserves. For the purpose of determining the figure to be proclaimed by the Secretary under the formula set forth in section 202 (b), certain reserves computed on a preliminary term method are to be adjusted by increasing or decreasing the reserves by 7 percent (see § 29.202-1). The reserves to be thus adjusted are reserves computed on preliminary term methods, such as the Illinois Standard or the Select and Ultimate methods. Only reserves on policies in the modification period are to be so adjusted. Where reserves under a preliminary term method are the same as on the level premium method, and in the case of reserves for extended or paid-up insurance, no adjustment is to be made. The reserves as thus adjusted, and the rate of interest on which they are computed should be reported in Schedule A, Form 1150A.

§ 29.201-7 Net income and deductions—(a) General. The net income of a life insurance company is its gross amount of income received during the taxable year from interest, dividends, and rents, less expenses, and general and administrative expenses under section 201 (c) (7) for wholly-tax-exempt interest, investment expenses, real estate expenses, and depreciation. In addition to the limitations on deductions relating to real estate owned and occupied by a life insurance company provided in section 201 (d), the limitations on the adjustment for amortization of premium and accrual of discount provided in section 201 (e), and the limitation on the deduction for investment expenses where general expenses are allocated to investment income provided in section 201 (c) (7) (B), life insurance companies are subject to the limitations on deductions relating to wholly-tax-exempt income provided in section 24 (a) (5). Life insurance companies are not entitled to the net operating loss deduction provided in section 23 (e).

(b) Wholly-tax-exempt interest. Interest which in the case of other taxpayers is excluded from gross income by section 22 (c) is included in the gross income of a life insurance company by section 201 (c) (1) is allowed as a deduction from gross income by section 201 (c) (7) (A).

(c) Investment expenses. The term "general expenses" as used in the internal revenue code means any expense incurred for the benefit of more than one department or division of the company rather than for the benefit of a particular department thereof. Any assignment of such expense to the investment department of the company for which a deduction is claimed under section 201 (c) (7) (B) subjects the entire deduction for investment expenses to the limitation provided in that section. The accounting procedure employed is not conclusive as to whether such eligibility has in fact been made. Investment expenses do not include Federal income and excess profits taxes.

If no general expenses are assigned to or included in investment expenses the deduction may consist of investment expenses actually paid during the taxable year in which an itemized schedule of such expenses must be appended to the return.

Investment expenses claimed under the purpose of determining the figure to be claimed under section 201 (c) (7) and this section are those which are owned and used, and to the extent used, for the purpose of producing the income specified in section 201 (c) (1). The expenses do not include real estate expenses, and at the extent owned and occupied, by the company. If general expenses are assigned to or included in investment expenses the maximum allowance will not be imposed unless it is shown to the satisfaction of the Commissioner that such allowance is justified by a reasonable assignment of actual expenses. Wages or salary included in investment expenses shall be disallowed as a deduction if determined by the National Labor Board, the Secretary of Agriculture, or the Commissioner to have been paid in contravention of the Act of October 2, 1942, 56 Stat. 765, 5 U.S.C. Sup., § 961, entitled "An Act to amend the Emergency Price Control Act of 1942, to aid in preventing inflation, and for other purposes." or of the regulations, orders, or rulings promulgated thereunder.

(d) Taxes and expenses with respect to real estate. The deduction for taxes and expenses with respect to real estate includes taxes and expenses paid during the taxable year exclusively upon or with respect to real estate owned by the company and any sum representing taxes or expenses as the case may be, which the company upon his interest as shareholder which is paid by the company without reimbursement from the shareholder. No deduction shall be allowed, however, for taxes, expenses, and the like upon or with respect to any real estate owned by the company except to the extent used for the purpose of producing income. (See paragraph (c) of this section.) As to real estate owned and occupied by the company see § 29.201-6.

(e) Depreciation. The deduction allowed for depreciation is, except as provided in section 201 (d), identical with that allowed other corporations by section 23 (1). The amount allowed by section 23 (1) in the case of life insurance companies is limited to depreciation sustained on the property used, and to the extent used, for the purpose of producing the income specified in section 201 (c) (1).

§ 29.201-8 Real estate owned and occupied. The amount allowable as a deduction for taxes, expenses, and depreciation upon or with respect to any real estate owned and occupied in whole or in part by a life insurance company is limited to an amount which bears the same ratio to such deduction (computed without regard to this limitation) as the rental value of the property not so occupied bears to the rental value of the entire property. For example, if the rental value of the space not occupied by the company is equal to one-half of the rental value of the entire property, the deduction for taxes, expenses, and depreciation is one-half of the taxes, expenses, and depreciation on account of the entire property. Where a deduction is claimed under the purpose of determining the figure to be claimed under section 201 (c) (7) and this section, the parts of the property occupied and the parts not occupied by the company, together with the respective rental values thereof, must be shown in a statement accompanying the return.

§ 29.201-9 Amortization of premium and accrued discount of discount. The adjustment for amortization of premium decreases, and for accrual of discount increases, (a) the gross income, (b) the deduction for wholly-tax-exempt interest, and (c) the credit for partially-tax-exempt interest.

The premium for any such security is the excess of its acquisition value over its maturity value and the discount is the excess of its maturity value over its acquisition value. The acquisition value of any such security is its cost (including buying commissions or brokerage but excluding any amounts paid for accrued interest) if purchased for cash, or if not purchased for cash, then its fair market value. The maturity value of any such security is the amount payable thereunder either at the maturity date or at some earlier call date. The earlier call date of any such security may be the earliest call date specified therein as a day certain, the earliest interest payment date if it is callable as provided in section 122 (a), the date which is the earliest date at which it is callable at par, or such other call or payment date, prior to maturity, specified in the security as may be selected by the life insurance company. A life insurance company which adjusts amortization of premium or accrual of discount with reference to a particular call or payment date must make the adjustments with reference to the value on such date and may not, after selecting such date, use a different call or payment date, or value, in the calculation of such amortization or discount with respect to such security unless the security was not in fact called or paid on such selected date.

The adjustments for amortization of premium and accrual of discount will be determined:

(1) According to the method regularly employed by the company, if such method is reasonable, or

(2) According to the method prescribed by this section.
A method of amortization of premium or accrual of discount will be deemed "regularly and uniformly followed" by a company if the method was consistently followed in taxable years beginning prior to January 1, 1942, or if for taxable years beginning on or after such date the company (1) consistently followed a different method in taxable years beginning prior to January 1, 1942; initiates or on before March 15, 1943, an adjustment under the tax net income (as determined in accordance with this section the aggregate of the sums of the normal-tax net income of the corporation and the gain from the method of amortization of premium or accrual of discount and (2) the appropriate amortization of the unearned premium tax net income so reduced, as provided in section 202 (b), for the company.

The method of amortization and accrual prescribed by this section is as follows:

(i) The premium (or discount) shall be determined in accordance with this section; and

(ii) The appropriate amortization of premium (or accrual of discount) attributed to the taxable year shall be obtained by multiplying the amount bears the same ratio to the premium (or discount) as the number of months in the taxable year during which the security was owned by the life insurance company bears to the number of months between the date of acquisition of the security and its maturity or earlier call date, determined in accordance with this section. For the purpose of this section the fractional part of a month shall be disregarded unless it amounts to more than half a month in which case it shall be considered as a month.

SEC. 202. ADJUSTED NORMAL-TAX NET INCOME

(a) Definition. For the purposes of section 201, the term "adjusted normal-tax net income" means the corporation net income as defined in section 202 (a) minus the reserve and other policy liability credit provided in subsection (b) and plus the amount of the adjustment for certain reserves provided in subsection (c).

(b) Reserve and other policy liability credit. As used in this section, the term "reserve and other policy liability credit" means the amount computed by multiplying the normal-tax net income by a factor, to be determined and proclaimed by the Secretary for each taxable year. This figure shall be based on such data with respect to life insurance companies for the preceding taxable year as the Secretary considers representative and shall be computed in accordance with the following formula: The ratio which (1) the aggregate of the normal-tax net income of the reserves for deferred dividends, (B) interest paid, and (C) the product of (1) the mean of the adjusted reserves at the beginning and end of the taxable year and (1) the reserve earnings rate bears to (2) the aggregate of the excess of net income computed without any deduction for tax-free interest, over the adjustment for certain reserves provided in subsection (c).

(c) Adjustment for certain reserves. In the case of a life insurance company writing contracts other than life insurance or annuity contracts (separately or combined with non cancellable health and accident insurance), the term "adjustment for certain reserves" means an amount equal to 3 percent of the tax-free interest and unpaid losses on such other contracts which are not included in life insurance reserves.

§ 29.202-1 Reserve and other policy liability credit for adjusted normal tax net income. Life insurance companies in computing adjusted normal-tax net income are allowed a "reserve and other policy liability credit" in lieu of a deduction for the interest allowed on their reserves, for interest paid and for deferred dividends. This credit is a flat percentage of the normal-tax net income. The factor is the same for all companies and is determined in accordance with this section the trust for the purpose of this section a fractional part of a month shall be disregarded unless it amounts to more than half a month in which case it shall be considered as a month.

The application of the reserve and other policy liability credit for the purpose of this section and section 203 may be illustrated by the following examples:

Example (1). The X Life Insurance Company for the calendar year 1922 had gross premium income, consisting of cash, $4,000,000, of which $700,000 consists of wholly tax-exempt interest. It has investment expenses of $600,000, real estate expenses of $20,000, and interest on $500,000 of corporate bonds at 4 per centum. Its net income and its normal-tax net income as defined in section 202 is $700,000 and $450,000. Since the Secretary has determined and proclaimed that for the taxable year 1923 the factor determined in accordance with this section the aggregate of the interest allowed on reserves, interest paid, and 2 percent of the interest allowed on the net premiums written during the preceding taxable year as the Secretary considers representative and the trust for the purpose of this section a fractional part of a month shall be disregarded unless it amounts to more than half a month in which case it shall be considered as a month. The application of the reserve and other policy liability credit for the purpose of this section and section 203 may be illustrated by the following examples:

Example (2). If in example (1) $100,000 of the gross premium income of the X Life Insurance Company for the calendar year 1922 consisted of partially tax-exempt interest, its corporation net income and its adjusted normal-tax net income would be the same as in the above example. Its normal-tax net income, however, would be $63,000,000 ($4,000,000 + $20,000,000 less $700,000 less $600,000), its credit would be $273,000 (30,300,000 x 0.93), and its adjusted normal-tax net income would be $212,000 ($30,300,000 - $2,703,000).

§ 29.202-2 Adjustment for certain reserves. A life insurance company writing contracts other than life insurance or annuity contracts (separately or combined with non cancellable health and accident insurance, and with governmental contract and accident insurance contracts) must add to its normal-tax net income and to its corporation surplus net income, as an adjustment to its tax-free interest other than tax-free interest, the tax-free interest credit, an amount equal to 3 percent of the mean of the unpaid premiums and unpaid losses at the beginning and end of the taxable year on such other contracts not included in life insurance reserves. If such unpaid premiums, however, are less than 25 percent of the net premiums written during the taxable year on such other contracts, then the amount to be added to the normal-tax net income and to corporation surplus net income is 3 percent of 25 percent of the net premiums written during the taxable year on such other contracts.
(c) Deductions allowed. In computing the net income of an insurance company subject to the tax imposed by this section, there shall be allowed as deductions:

(1) All necessary expenses incurred, as provided in section 23 (a);
(2) All interest as provided in section 23 (b);
(3) Taxes as provided in section 23 (c);
(4) Losses incurred as defined in subsection (b) (5) of this section;
(5) Gross premiums earned, less losses incurred to the extent provided in section 117 plus losses from capital assets sold or exchanged in order to obtain normal-tax net income and to provide for the payment of dividends and similar distributions to policyholders. Capital assets shall be considered sold, in the case of a foreign corporation the deduction for the tax imposed by this section there shall be allowable as deductions:

(6) Expenses incurred. "Expenses incurred" means all expenses shown on the annual statement approved by the National Convention of Insurance Commissioners and (b) gain during the taxable year from the sale or other disposition of property, and (C) all other items constituting gross income under section 29;
(2) Net income. "Net income" means the gross income as defined in paragraph (1) of this subsection less the deductions allowed by subsection (c) of this section;
(3) Investment income. "Investment income" means the amount of gross premiums written on insurance contracts during the taxable year, less losses incurred and expenses incurred;
(4) Underwriting income. "Underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;
(5) Premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;
(6) Losses incurred. "Losses incurred" means losses incurred during the taxable year on insurance contracts, computed as follows:

(a) The amount of losses incurred during the taxable year which under section 22 (q) and were paid or declared to policyholders in the case of a foreign corporation the deduction for the tax imposed by this section there shall be allowable as deductions:

(b) Deductions of foreign corporations. The term "paid or declared" shall be defined by the method of accounting regularly employed in keeping the books of the insurance company.
(c) Deductions of foreign corporations. The term "paid or declared" shall be defined by the method of accounting regularly employed in keeping the books of the insurance company.

(d) Deductions of foreign corporations. The term "paid or declared" shall be defined by the method of accounting regularly employed in keeping the books of the insurance company.

(e) Deductions allowed. In computing the net income of an insurance company subject to the tax imposed by this section, there shall be allowed as deductions:

(1) All necessary expenses incurred, as provided in section 23 (a);
(2) All interest as provided in section 23 (b);
(3) Taxes as provided in section 23 (c);
(4) Losses incurred as defined in subsection (b) (5) of this section;
(5) Gross premiums earned, less losses incurred to the extent provided in section 117 plus losses from capital assets sold or exchanged in order to obtain normal-tax net income and to provide for the payment of dividends and similar distributions to policyholders. Capital assets shall be considered sold, in the case of a foreign corporation the deduction for the tax imposed by this section there shall be allowable as deductions:

(6) Expenses incurred. "Expenses incurred" means all expenses shown on the annual statement approved by the National Convention of Insurance Commissioners and (b) gain during the taxable year from the sale or other disposition of property, and (C) all other items constituting gross income under section 29;
and all other items constituting gross income under section 22. See section 22 (a), (b), and (e) and sections 23 and 334. It does not include increase in liabilities during the year on account of reinsurance treaties, remittances from the home office of a foreign insurance company to the United States branch, borrowed money, or gross increase due to adjustments in book value of capital assets. The underwriting and investment exhibit is prepared clearly to reflect the true net income of the company, and in so far as it is not inconsistent with the provisions of the Internal Revenue Code will be recognized and used as a basis for that purpose. All items of the exhibit, however, do not reflect an insurance company's income as defined in the Code. By reason of the definition of investment income, miscellaneous items which are intended to reflect surplus but do not properly enter into the computation of income, such as dividends declared to shareholders in their capacity as such, War Department Insurance is not included as income. Gains or loss from agency balances and items of property are deductible subject to the limitation contained in section 117 (c) (1). 117 (d) (1). The graduated percentage deduction is the same as that allowed mutual insurance companies other than life or marine, see section 207 (b) (4) (F) and the regulations thereunder. Insurance companies are also allowed a deduction for dividends and similar distributions paid or declared to policyholders in their capacity as such. The deduction is the same as that allowed mutual insurance companies other than life or marine. See section 207 (b) (3) and the regulations thereunder.

Among the items which may not be deducted are income and profits taxes imposed by the United States, income taxes levied by other governmental units of the United States in connection with the underwriting and investment exhibit, will be included in amounts which are intended to reflect surplus but do not enter into the computation of income. Home office remittances and regular ordinary expenses, and special deposits, are ignored. As such, home office remittances and regular ordinary expenses, and special deposits, are ignored. However, it does not include increase in liabilities during the year on account of reinsurance treaties, remittances from the home office of a foreign insurance company to the United States branch, borrowed money, or gross increase due to adjustments in book value of capital assets. The underwriting and investment exhibit is prepared clearly to reflect the true net income of the company, and in so far as it is not inconsistent with the provisions of the Internal Revenue Code will be recognized and used as a basis for that purpose. All items of the exhibit, however, do not reflect an insurance company's income as defined in the Code. By reason of the definition of investment income, miscellaneous items which are intended to reflect surplus but do not properly enter into the computation of income, such as dividends declared to shareholders in their capacity as such, War Department Insurance is not included as income. Gains or loss from agency balances and items of property are deductible subject to the limitation contained in section 117 (c) (1). 117 (d) (1). The graduated percentage deduction is the same as that allowed mutual insurance companies other than life or marine, see section 207 (b) (3) and the regulations thereunder.

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insurance contract but depends upon the experiences of the particular company or the insurance business in the particular class of business; and (2) the amount of discount on bonds, notes, or other obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest on which is wholly exempt from taxation under this chapter.

(3) Dividends to policyholders. “Dividends to policyholders” means dividends and similar distributions paid to or declared to policyholders. The term “paid or declared” shall be construed according to the method regularly employed by the company in making similar distributions to policyholders.

(4) Net income. The term “net income” means the gross investment income of a taxpayer, less the deduction of the amount of any losses and expenses paid or accrued during the taxable year, including the deductions of the amount of any taxes, including the tax imposed by section 207 (a), from the gross amount of income from Interest, dividends, rents, and annuities, and from sales or exchanges of capital assets, and from any other source not included in gross income for Federal income tax purposes, to the extent that the gross receipts from their sale or exchange are included in gross income for such purposes.

(5) Real estate expenses. Expenses of any real property which under section 22 (b) (4) shall be construed according to the method regularly employed by the company in making similar distributions to policyholders.

(6) Rental value of real estate. The rental value of the space not so occupied bears to the rental value of the entire property the same ratio that the amount of discount on bonds, notes, or other obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) which have been paid or declared to the taxpayer the interest on which is wholly exempt from taxation under this chapter, bears to the rental value of the entire property.

§ 29.207–1 Tax on mutual insurance companies other than life or marine.

All mutual insurance companies other than life or marine are subject to the same penalties as are provided for in section 29.207 (a), but are taxable as other foreign corporations. See section 231.

§ 29.207–2 Tax on other foreign corporations.

Under section 207 (a), companies with normal-tax net incomes of between $8,000 and $6,183.66, and with corporation surtax net incomes of between $3,000 and $6,000, pay a normal tax, at the base of 30 percent, and a surtax, at the rate of 20 percent, on that portion of the normal-tax net income, and of the corporation surtax net income, respectively, in excess of $3,000. Under section 207 (a), (2), companies with gross amounts of income from interest, dividends, rents, and net premiums, minus dividends to policyholders, minus wholly tax-exempt interest, over the amount of the tax imposed under subchapter E of chapter 2.

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Interinsurers and reciprocal underwriters with corporation surtax net in-
comes of over $50,000 are taxed under section 207 (a) (3) upon normal-tax net income and corporation surtax net income at the rate provided in section 11. Under section 14 (a) (4) and in section 15 (b).

Under section 207 (a) (3) insurers and reciprocal insurers with normal-tax net incomes and corporation surtax net incomes between $6,000 and $100,000 pay a normal tax, at the rate of 48 percent, and a surtax, at the rate of 32 percent, on that portion of the normal-tax net income and the corporation surtax net income, respectively, in excess of $50,000.

Section 207 (a) (4) provides for an adjustment of the amount computed under section 207 (a) (3) where the gross amount received during the taxable year from interest, dividends, rents, and premiums (including deposits and assessments) is over $75,000 and less than $125,000. The adjustment reduces the tax otherwise computed under those sections to an amount which bears the same proportion to such tax as the excess over $50,000 bears to $100,000.

The application of section 207 (a) (1), (2), (3), and (4) may be illustrated by the following examples:

Example (1). The X Company, a mutual casualty insurer, for the taxable year 1942 has a corporation surtax net income of $63,500 and due to partially tax-exempt interest of $650, a normal-tax net income of $5,200. The gross amount received during the taxable year from interest, dividends, rents, and premiums (including deposits and assessments) is $52,700, or a total of $77,500 and less than $125,000. The adjustment reduces the tax otherwise computed under those sections to an amount which bears the same proportion to such tax as the excess over $50,000 bears to $100,000.

Example (2). The Y Company, a mutual insurance company other than life or marine is its gross investment income during the taxable year 1942 as its normal-tax net income does not exceed $3,000. Its surtax is 20 percent of $3,000 or $600.

Example (3). The Z Company, a mutual fire insurance company, for the taxable year 1942 has a normal-tax net income of $65,000, a corporation surtax net income of $67,000, and an adjusted gross premium income of $100,000. The gross amount received from interest, dividends, rents, and premiums (including deposits and assessments) is $70,000, and the gross amount of income from interest, dividends, rents, and net premiums, minus dividends to policyholders, minus wholly tax-exempt interest is $70,000. The Z Company would be required to pay tax return based on section 207 (a) (4) in excess of $50,000. Under section 207 (a) (4) (1), without application of section 207 (a) (4), the normal tax

§ 29.207-1 Net Premiums. Net premiums are the items used, with interest, dividends, and rent, less dividends to policyholders and wholly tax-exempt interest, in determining taxable income. The term "net premiums" is defined in section 207 (a) (2). They are also used in section 297 (b) (4) (C) in determining the limitation on certain capital losses and in the application of section 117 (a). The term "net premiums paid" as defined in section 207 (b) (2) and includes deposits and assessments, but excludes amounts returned to policyholders which are treated as dividends under section 207 (b) (4).

§ 29.207-2 Net premiums. Net premiums are the items used, with interest, dividends, and rent, less dividends to policyholders and wholly tax-exempt interest, in determining taxable income. The term "net premiums" is defined in section 207 (a) (2). They are also used in section 297 (b) (4) (C) in determining the limitation on certain capital losses and in the application of section 117 (a). The term "net premiums paid" as defined in section 207 (b) (2) and includes deposits and assessments, but excludes amounts returned to policyholders which are treated as dividends under section 207 (b) (4).
The application of section 207 (b) (4) (F) may be illustrated by the following examples:

Example (1). The X Company, a mutual fire insurance company, in the taxable year 1942 sells capital assets in order to obtain funds to make capital contributions and to provide for the payment of dividends and similar distributions to policyholders. The gross receipts from the sale of $11,750, resulting in losses of $2,000. It pays dividends to policyholders of $150,000, losses of $2,000, and expenses of $35,000. It receives interest of $9,000, other capital gains of $3,000, rents of $4,000, and net premiums of $66,000. The excess of the sum of dividends, losses and expenses paid ($200,000) over the sum of interest, dividends, rents, and net premiums received ($125,000) is $75,000. As the gross from this source ($11,750) do not exceed such excess ($75,000), the losses of $20,000 are allowable as a deduction from gross insurance income.

Example (2). In the example the gross receipts were $76,000 and the last capital asset sold, for the purpose therein specified, resulted in a gain of $6,000 and a loss of $500, the losses allowable as a deduction from gross investment income would be $19,750. The excess of the gross receipts of $76,000 exceed by $6,000 $70,000, the excess of the sum of dividends, losses and expenses paid ($200,000) over the sum of interest, dividends, rents, and net premiums received ($125,000). The gross receipts and the resulting loss from the last capital asset sold is allowable in the amount of the excess of $6,000 to the gross receipts of $70,000, or 9 percent. Fifty percent of the loss of $500 is deductible from the total loss of $500. The remaining gross receipts of $76,000, less $500, and the proportionate loss of $250 should be reported as capital losses under section 117.

Example (3). If in example (1) the X Company had a corporation surtax net income of $9,750 and, under the provisions of section 117, had capital losses of $18,000 and capital gains of $10,000, the net capital loss for the taxable year 1942 in applying section 117 (e) for the purposes of section 207 (b) (4) (F), would be $8,000. This is determined by subtracting from total losses of $59,000 ($18,000 capital losses, $20,000 other losses, and $21,000 other capital losses under section 207 (b) (4) (F)) the sum of capital gains of $10,000 and expenses paid $35,000 of capital assets sold or exchanged to obtain funds to meet abnormal insurance losses and to provide for similar distributions to policyholders of $50,000. Such losses of $50,000 are added to capital gains of $10,000, since they are less than corporations surtax net income, computed without regard to gains or losses from sales or exchanges or capital assets, of $29,750 ($20,000 corporation surtax net income plus $500 other capital losses under section 207 (b) (4) (F) plus the portion of capital losses allowable under section 117 (e) for mixtures capital gains under section 117 (e) of $10,000).
commodity exchange, if the transaction is of the kind customarily consummated at such place, and if the alien, partnership, or corporation has no office or place of business in the United States at the time of the transaction. In any taxable year the income derived from all sources including sources within the United States shall be taxable with respect to amounts received after the ninth of October therefrom by a resident alien Individual not engaged in trade or business within the United States who is not a nonresident alien Individual not engaged in trade or business within the United States, and if the alien has filed or the papers taken in determining the facts, require an affidavit or affidavits setting forth the facts relied upon, executed by some credible person or persons, other than the alien and members of his family, who have knowledge of the same, within six months prior to the date of execution of the affidavit or affidavits.

§ 29.211-5 Loss of residence by alien. An alien who has acquired residence in the United States retains his status as a resident until he abandons the same and actually departs from the United States. An intention to change his residence does not change his status as a resident alien to that of a nonresident alien. Thus, an alien who has acquired residence in the United States is taxable as a resident for the remainder of his stay in the United States.

§ 29.211-6 Duty of employer to determine status of alien employee. If wages are paid to aliens without withholding the tax, except as permitted in § 29.213-5, in the case of a resident of Colombia, El Salvador, or Mexico, the employer should be prepared to prove the status of the alien as provided in §§ 29.211-1 to 29.211-5, inclusive. An employer may rely upon the evidence of residence afforded by the fact that an alien has filed Form 1078, or an equivalent certificate of the alien establishing residence. An employer need not secure Form 1078 from the alien if he is
satisfied that the alien is a resident alien. An employer who seeks to account for failure to withhold in the past, if he had not at the time secured Form 1076 or its equivalent, is permitted to prove the former claim of the alien individual by any competent evidence. The written statement of the alien employee may ordinarily be relied upon by the employer as proof that the alien is a resident of the United States.

§ 29.211-7 Taxation of nonresident alien individuals. For the purposes of this section and §§ 29.212–1, 29.213–1, 29.214–1, 29.215–1, and 29.215–2, nonresident alien individuals are divided into three classes: (1) Nonresident alien individuals not engaged in trade or business within the United States at any time during the taxable year and deriving in the taxable year not more than $15,400 gross amount of fixed or determinable annual or periodical income from sources within the United States; (2) Nonresident alien individuals engaged in trade or business within the United States at any time during the taxable year and deriving in the taxable year more than $15,400 gross amount of fixed or determinable annual or periodical income from sources within the United States; and (3) nonresident alien individuals who at any time during the taxable year are engaged in trade or business in the United States.

(a) Non United States business; general rule. A nonresident alien individual within class (1), referred to in the preceding paragraph, is liable to the tax upon the excess of income from sources within the United States, determined under the provisions of section 119, which is fixed or determinable annual or periodical gains, profits, and income, for the taxable year over the amount of interest, certain annuities and pensions received on and after January 1, 1941, by individual residents of Canada, which are exempt from tax.

(b) Non United States business; aggregate more than $15,600. A nonresident alien individual within class (2), referred to in the first paragraph of this section, is liable to the tax upon the excess of income from sources within the United States, determined under the provisions of section 119, which is fixed or determinable annual or periodical income received on or after April 30, 1941, by a nonresident alien individual who is a resident of Canada (see §§ 7.10 to 7.17, inclusive, of this chapter).

(c) United States business. A nonresident alien individual within class (3) referred to in the first paragraph of this section, is not taxable at the rate of 30 percent (27½ percent prior to October 31, 1942) upon the gross amount of fixed or determinable annual or periodical income enumerated in section 211 (a). The net income from sources within the United States of such a nonresident alien individual (gross income from sources within the United States less the deductions provided in sections 23 and 213) less the credits against net income allowable to an individual by section 25, is subject to the normal tax of 6 percent on such net income. Such 6 percent tax is imposed by section 12 (b), and the victory tax imposed by section 450.

As used in sections 119, 143, 144, 211, and 231, the phrase "engaged in trade or business within the United States" includes the performance of personal services within the United States at any time during the taxable year but does not include the performance of personal services by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 30 days during the taxable year and whose compensation for such services does not exceed $150.

Neither the beneficiary nor the grantor of a trust, whether resident alien or nonresident alien, is deemed to be engaged in trade or business in the United States merely because the trustee is engaged in trade or business in the United States.

Sec. 212. Gross income.

(a) General rule. In the case of a nonresident alien individual gross income includes only the gross income from sources within the United States.

(b) Income from ships under foreign flag. The income of a nonresident alien individual which consists exclusively of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations engaged in the United States shall not be included in gross income and shall be exempt from taxation under this chapter.
come a nonresident alien subsequent to its receipt and prior to the close of the taxable year. Conversely, income received by a nonresident alien from sources without the United States is not taxable though such person may become a resident alien subsequent to its receipt and prior to the close of the taxable year.

(a) No United States business. The gross income of a nonresident alien individual who at any time during the taxable year was engaged in trade or business within the United States is not limited to the items of gross income specified in section 211 (a) or section 211 (b), is gross income from sources within the United States and is considered as granting an equivalent exemption within the meaning of this section.

(b) United States business. The gross income of a nonresident alien individual who at any time during the taxable year was engaged in trade or business within the United States is not limited to the items of gross income specified in section 211 (a) or section 211 (b), but includes any item of gross income treated as income from sources within the United States, except those items which are exempt from taxation by statute or treaty or which are not taxable by the Federal Government under the laws of foreign countries which either impose income tax, or, in imposing such tax, exempt from taxation as much of the income as a citizen of the United States is engaged in such foreign country and of a corporation organized in the United States as is derived from the operation of a ship or ships documenting under the laws of the United States. Such income shall not be included in gross income.

§ 23.212-2 Exclusion of earnings of foreign ships from gross income. So much of the income from sources within the United States of a nonresident alien individual which is engaged in a trade or business within the United States, and all gains, profits and losses derived from the sale within the United States of personal property, or of real property, or from the operation of a ship or ships documenting under the laws of the United States as is derived from the operation of a ship or ships, whether or not the foreign country under the laws of which such ships are documented meets the equivalent exemption within the meaning of this section.

A nonresident alien individual not engaged in trade or business within the United States at any time during the taxable year is not required to include in gross income such income from sources within the United States as is derived from the operation of a ship or ships, whether or not the foreign country under the laws of which such ships are documented meets the equivalent exemption within the meaning of the Internal Revenue Code.

Ssc. 231. Deductions. (a) General rule. In the case of a nonresident alien individual the deduction shall be allowed in respect to any item of income from sources within the United States that they are connected with income from sources within the United States and the proper apportionment and allocation of the deductions within respect to income from sources within the United States shall be determined as provided in section 119, under rules prescribed by the Commissioner with the approval of the Secretary.

(b) Losses. (1) The deduction, for losses not connected with trade or business, if incurred in transactions entered into for profit, allowed by section 23 (e) (2) shall be allowed whether or not connected with income from sources within the United States, but only if the profit, if such transaction had resulted in a profit, would be taxable under this chapter.

(2) The deduction for losses not connected with the trade or business of certain partnerships or corporations engaged in a trade or business of the United States, and allowed by section 23 (a) (3), shall be allowed whether or not connected with income from sources without the United States.

(c) Charitable, etc. contributions. The so-called "charitable contribution" deduction allowed by section 23 (e) shall be allowed whether or not connected with income from sources without the United States.

§ 23.213-1 Deductions allowed nonresident alien individuals. (a) No United States business.—(1) General rule. In general, a nonresident alien individual not engaged in trade or business within the United States at any time during the taxable year is not allowed any deductions, the tax being imposed upon the amount of gross income received.

(2) Aggregate more than $15,400. A nonresident alien individual (other than a resident of Canada) not engaged in trade or business within the United States at any time during the taxable year and deriving for such year more than $15,400 gross amount of fixed or determinable annual or periodical income from sources within the United States is allowed for such year only such deductions as are properly allocable to such income. He is also allowed the contributions or gifts made within the taxable year of income from sources within the United States but only if made to domestic corporations or to community chests, funds, or foundations created in the United States within the meaning of section 23 (e), or to the vocational rehabilitation fund, subject to the limitations provided in section 23 (e).

(b) United States business. In the case of a nonresident alien individual who at any time within the taxable year was engaged in trade or business within the United States the deductions allowed by section 23 for business expenses, including taxes, losses in trade, bad debts, depreciation, and depletion are allowed only if and to the extent that they are connected with income from sources within the United States. (See also section 215.) In the case of such taxpayers, however, (1) losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, although not connected with the trade or business, are (if otherwise allowable) deductible only if and to the extent that the profit, if such transaction had resulted in a profit, would be taxable as income from sources within the United States; (2) losses sustained during the taxable year of property not connected with the trade or business if arising from fires, storms, shipwrecks, or other casualty, or from theft, and if not compensated for by insurance or otherwise, are deductible only if the property
was located within the United States; and (3) contributions or gifts made within the taxable year are deductible, only if made to domestic corporations or to community chests, funds, or foundations created under United States tax laws, that are not exempt from section 23 (o), or to the vocational rehabilitation fund, subject to the limitation provided in section 23 (o).

Losses embraced under paragraph (a) (2) of this section are deductible in full from items of gross income specified as being derived in full from sources within the United States, and, if greater than the sum of such items, the unabsorbed loss may be deducted from the income apportioned to sources within the United States under the provisions of § 29.119-12.

Losses embraced under paragraph (a) (1) are deductible in full (as provided in § 29.119-10 or § 29.119-11) when the profit from the transaction, if it had resulted in a profit, would have been taxable in full from sources within the United States. But losses should be deducted under the provisions of § 29.119-12 when the profit from the transaction, if it had resulted in profit, would have been taxable only in part.

§ 29.214. Credits to nonresident alien individuals (as amended by sec. 6 (b), Rev. Act 1940; sec. 111 (b), Rev. Act 1941; sec. 131 (a), Rev. Act 1942). In the case of a nonresident alien individual the personal exemption allowed by section 26 (b) (1) of this chapter shall, except as hereinafter the case of a resident of a country other than the United States not residing in such country, be only $500. In the case of a nonresident alien individual residing in a country other than the United States not residing in such country, the personal exemption allowed by section 26 (b) (2) is allowed to nonresident alien individuals who at any time within the taxable year were engaged in trade or business within the United States only if they are residents of Canada or Mexico. If the status of the taxpayer as to dependents changes during the taxable year, the credit for dependents shall be determined as provided in § 29.25-7.

§ 29.215. Allowance of deductions and credits

(a) Return to contain information. A nonresident alien individual shall receive the personal exemption allowed by section 26 (b) (1), and the deductions and credits allowed to him in this chapter only if filing or causing to be filed with the collector a true and accurate return of his income as received from all sources in the United States, in the manner prescribed in this chapter; including therein all the information which the Commissioner may deem necessary for the calculation of such deductions and credits.

(b) Tax withheld as source. The benefit of the provisions of this chapter may be obtained for dependents for whom he is a resident of a contiguous country, unless a resident alien entitled thereto, by filing a claim therefor with the withholding agent.

§ 29.214-1. Credits to nonresident alien individuals—(a) No United States business—(1) General rule. In general, a nonresident alien individual who is a resident of a country other than the United States not residing in such country, who is a citizen of the United States, and who is married and living with husband or wife, or who is the head of a family, the personal exemption allowed by section 26 (b) (1) of this chapter, subject to the limitation provided in section 23 (o), is allowed to nonresident alien individuals who at any time within the taxable year were engaged in trade or business within the United States only if they are residents of Canada or Mexico. If the status of the taxpayer as to dependents changes during the taxable year, the credit for dependents shall be determined as provided in § 29.25-7.

(b) United States business. In the case of a nonresident alien individual who at any time within the taxable year was engaged in trade or business within the United States, the personal exemption allowed by section 26 (b) (2) is allowed to nonresident alien individuals who at any time within the taxable year were engaged in trade or business within the United States only if they are residents of Canada or Mexico. If the status of the taxpayer as to dependents changes during the taxable year, the credit for dependents shall be determined as provided in § 29.25-7.

§ 29.215-1. Allowance of deductions and credits to nonresident alien individuals—(a) No United States business—(1) General rule. In general, a nonresident alien individual not engaged in trade or business within the United States at any time during the taxable year is not entitled to any allowance of deductions or credits even though he may file a return of income.

(b) Aggregate more than $15,400. In the case of a nonresident alien individual (other than a resident of Canada) not engaged in trade or business within the United States, and deriving a gross amount of fixed or determinable annual or periodical income from sources within the United States or more $15,400, there are those applicable in the case of nonresident alien individuals engaged in trade or business within the United States.
FEDERAL REGISTER, Thursday, November 4, 1943

with respect to his tax liability under Sub-

section 119 (a) (2) (B), and shall pay the balance of the tax shown to be due.

(a) Aggregate more than $15,400. A nonresident alien individual (other than

a resident of Canada) not engaged in trade or business within the United

States at any time during the taxable year deriving in such year a gross income of

more than $15,400 shall pay a tax based on the difference between the tax withheld

under Subchapter D of Chapter 9 and the tax on the income derived therein.

(b) Withholding at source. For withholding tax at source on income of nonresi-

dent aliens, see section 145.

§ 29.218-4 Date on which tax shall be paid by nonresident alien individual. In the

case of a nonresident alien individual, the tax is to be paid on or before the 15th
day of June following the close of the calendar year, or, where the return is

made on the basis of the fiscal year, on or before the 15th day of the fiscal year

following the close of the fiscal year. (Note: The case of a nonresident alien in-

dividual not engaged in trade or business within the United States consists of

compensation for personal services and does not exceed $500 during the taxable

year deriving in such year more than $15,400, if he is not otherwise engaged in

trade or business within the United States. Such return need not be made on the

basis of the calendar year. See § 29.217-5, relating to installment payments.)

§ 29.219-1 Partnerships. Whether a nonresident alien individual who is a

member of a partnership is taxable under the provisions of sections 291 or 611 (a)
or 211 (e) or (B) section 211 (b) may depend on the status of the partnership.

A nonresident alien individual who has a nonresident partner is a partner in

the United States if the tax under sections 291 or 611 (a) or 211 (e) or (B) sec-
tion 211 (b) is paid by the partnership. The tax on the income derived by a non-

resident partner is deductible as a business expense by the United States partnership.

For the purpose of this section, any entity which is subject to the provisions of

sections 211 (a) or 211 (e), as the case may be, is considered as a partnership for

purposes of determining whether the partnership is engaged in trade or business

within the United States. (An individual who is resident outside the United States,

and who has a nonresident partner in the United States, may be subject to tax

under section 211 if the tax is paid by the partnership.) (See § 23.211-7.)

NOTE: CORPORATION.
and paid for each taxable year, in lieu of the tax imposed by sections 13 and 14, upon the amount received by any foreign corporation not engaged in trade or business within the United States, from sources within the United States as interest (except interest on deposits with banks of any kind) received from sources within the United States less the credit allowed by section 29 (b), which credit is limited in amount to 85 percent of its net income from sources within the United States as interest.

As used in sections 119, 124, 144, 211, and 231, the phrase "engaged in trade or business within the United States" includes the performance of personal services within the States at any time within the taxable year. Such phrase does not include the effecting of transactions in the United States in stocks, securities, or commodities (including hedging transactions) through a resident broker, commission agent, or custodian. The term "commodities" as used in section 211 (b) means only goods of a kind customarily dealt in on an organized commodity exchange, such as farm products, raw materials, or a cotton futures market, and does not include merchandise in the ordinary channels of commerce.

§ 29.231-2 Gross income of foreign corporations.

In the case of a foreign corporation, as defined in section 29.233 (b), engaged in insurance business within the United States (see section 29.237 (a), (b), and (c)), but not in a "life" or "mutual" company other than "life" or "mutual" not carrying "on an insurance business within the States" (see section 29.237 (a)), the term "gross income" means gross income from sources within the United States, including, among other things, foreign corporation organized under the laws of any country in North, Central, or South America, or in the West Indies, or of Newfoundland such rate as to items of such income received on or after January 1, 1940, by Swedish corporations and exempt from Federal income tax under the provisions of the tax convention between the United States and Sweden, effective January 1, 1940, and regulations thereunder (see Part 25 of this chapter). Under the provisions of the tax convention between the United States and Canada (ratifications exchanged June 15, 1942, the tax rates of 27 1/2 percent or 30 percent, as the case may be, otherwise indicated by section 221 (a), are reduced to 18 percent as to items of income in the case of such corporations organized under the laws of Canada.

§ 29.231-1 Taxation of foreign corporations.

For the purposes of this section and §§ 29.231-2, 29.232-1, 29.235-1, 29.235-2 and 29.235-3, foreign corporations are divided into two classes: (1) foreign corporations not engaged in trade or business within the United States at any time within the taxable year, referred to in this regulation as foreign corporations (see § 29.3707-8) ; and (2) foreign corporations which at any time within the taxable year are engaged in trade or business within the United States, referred to in the regulations as resident foreign corporations (see § 29.3707-8).

(a) Nonresident foreign corporations.

A nonresident foreign corporation is liable to the tax upon the amount received from sources within the United States, determined under the provisions of section 119, which is fixed or determinable annual or periodical gains, profits, and income. For the purposes of section 321 (a), the term "amount received" means "gross income." Specific items of fixed or determinable annual or periodical income are enumerated in the Internal Revenue Code as interest (except interest on deposits with persons carrying on the banking business), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments made, fixed or determinable annual or periodical gains, profits, and income, a tax of 30 percent of such amount, except that in the case of corporations organized under the laws of any country in North, Central, or South America, or in the West Indies, or of Newfoundland such rate as to items of such income received on or after January 1, 1940, by Swedish corporations and exempt from Federal income tax under the provisions of the tax convention between the United States and Sweden, effective January 1, 1940, and regulations thereunder (see Part 25 of this chapter).

(b) Resident foreign corporations.

A resident foreign corporation is not taxable upon the items of fixed or determinable annual or periodical income enumerated in section 321 (a) at the rate specified in that section. A resident foreign corporation (see § 29.3707-12), liable to a tax of 24 percent of its normal-tax net income (regardless of the amount thereof), that is, its net income from sources within the United States (gross income from sources within the United States minus the statutory deductions provided in sections 23 and 233) less the credits allowed against net income (see section 29.230 (a) and (b)). A resident foreign corporation also subject to the corporation surtax at the following rates:

(1) Upon corporation surtax net income of more than $50,000, 12 percent of the entire amount thereof.

(2) Upon corporation surtax net income over $25,000 but not over $50,000, $2,500, plus 22 percent of the amount of such income in excess of $25,000.
States of personal property or real property located therein.

(b) Resident foreign corporations. The gross income from sources within the United States of a resident foreign corporation is not limited to the items of fixed or determinable annual or periodical income referred to in section 1901 (a), but includes every item of gross income which is treated as income from sources within the United States, except those items which are specifically exempt from taxation by statute or regulation, or which are not taxable by the Federal Government under the Constitution. (See section 22 (b), 119, and 221 (d) J.)

A foreign corporation which effectuates transactions in the United States, such as stocks, securities, or commodities (including hedging transactions) through a resident broker, commission agent, or custodian is not merely by reason of such transactions considered as being engaged in trade or business within the United States which would cause it to be classed as a resident foreign corporation.

However, a foreign corporation which has any part of its income from sources within the United States, being a resident foreign corporation, is taxable upon all income derived from sources within the United States, including the profits realized from such transactions. A resident foreign corporation is also required to include in its gross income capital gains, gains from hedging transactions, and personal holding companies income which is treated as income from corporation under section 221 (a); but includes every item of gross income from sources within the United States, including the profit received from sources without the United States which would cause it to be deemed a resident foreign corporation. The returns of its total income received from sources within and without the United States shall be determined as provided in section 119. As to foreign life insurance companies, see § 29.201 (b).

§ 29.231-1 Allocation of deductions and credits. A foreign corporation shall receive the benefit of the deductions and credits allowed to it in this chapter only if filing or causing to be filed with the collector a true and accurate return of its total income received from all sources within the United States, in the manner prescribed in this chapter; including therein all the information which the Commissioner may deem necessary for the calculation of such deductions and credits.

§ 29.231-2 Time and place for filing returns of foreign corporations.—(a) Nonresident foreign corporations. The return in the case of a nonresident foreign corporation must be made on or before the fifteenth day of the sixth month following the close of the fiscal year, or, if the return is made on the basis of a calendar year then on or before the fifteenth day of June. If a nonresident foreign corporation has had an agent in the United States, the return shall be made by the agent.

(b) Resident foreign corporations. The return in the case of a resident foreign corporation must be made on or before the fifteenth day of the sixth month following the close of the fiscal year, or, if the return is made on the basis of a calendar year then on or before the fifteenth day of June. 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.
(b) Resident foreign corporations. If a foreign corporation at any time within the taxable year is a resident corporation it shall make a full and accurate return on Form 1120 of its income received from sources within the United States.

Sec. 228. Payment of tax.

(a) Time of payment. In the case of a foreign corporation not having any office or place of business in the United States the total amount of tax imposed by chapter 1 shall be paid, in lieu of the time prescribed in section 30, on the 15th day of June following the close of the calendar year, or, if the return should be made on the basis of a fiscal year, then on the 15th day of the sixth month following the close of the fiscal year.

(b) Withholding at source. For withholding at source of tax on income of foreign corporations, see section 144.

§ 29.236-1 Dates on which tax shall be paid by foreign corporations. (a) Nonresident foreign corporations. In the case of a nonresident foreign corporation the total amount of tax imposed by chapter 1 shall be paid, in lieu of the time prescribed in section 30, on the 15th day of June following the close of the calendar year, or if the return should be made on the basis of a fiscal year, then on the 15th day of the sixth month following the close of the fiscal year. As to payment of the tax in installments, see § 39.56-1. For provisions relating to certain cases in which the date otherwise prescribed for the payment of the tax or an installment thereof is postponed by reason of the war, see Part 472 of this chapter.

(b) Resident foreign corporations. In the case of a resident foreign corporation the total amount of tax imposed by chapter 1 shall be paid, in lieu of the time prescribed in section 30, on the 15th day of March following the close of the taxable year, or if the return is made on the basis of a fiscal year, then on the 15th day of the third month following the close of the fiscal year. If the return is made for a period ending on the 30th day of June or of any other date, the tax shall be paid at the times prescribed in § 29.56-1 (a). As to payment of the tax in installments, see § 39.56-1. For provisions relating to certain cases in which the date otherwise prescribed for the payment of the tax or an installment thereof is postponed by reason of the war, see Part 472 of this chapter.

§ 29.251-1. Citizens of the United States and domestic corporations deriving income from sources within the United States. In the case of a citizen of the United States or a domestic corporation deriving income from sources within the United States or a possession of the United States, the income from such sources shall be included in gross income. The phrase "income from sources within the United States or of the United States" as used in this section means the income derived from sources within the United States, or of the United States, or directly controlled by the United States.

(a) General rule. In the case of a citizen of the United States, the term "income" as used in this section means the income derived from sources within the United States or possessions of the United States or from income which is attributable to sources within the United States or possessions of the United States. In the case of a domestic corporation, the term "income" as used in this section means the income derived from sources within the United States or possessions of the United States or from income which is attributable to sources within the United States or possessions of the United States.

(b) Tax rate. The tax on income from sources within the United States or possessions of the United States shall be computed at the rate of 15% of the amount of such income. The tax shall be computed under the rules prescribed by the regulations of the Commissioner of Internal Revenue.

(c) Determination of income from sources within the United States. The amount of income from sources within the United States shall be determined by the regulations of the Commissioner of Internal Revenue.

(d) Withholding at source. For withholding at source of tax on income from sources within the United States, see section 144.

(2) If, in the case of such corporation, 60 per centum or more of its gross income computed without the benefit of section 261 for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States, the tax imposed by section 261 on the income derived from the active conduct of a trade or business within a possession of the United States shall be computed at the rate of 60% of the amount of tax imposed under section 261 for such period or such part thereof.

(e) Deductions. In the case of a citizen, the tax shall be reduced by the deductions, if any, allowed by section 156, 157, 158, 159, 160, 161, and 162, of the Internal Revenue Code, and by the deductions allowed by section 295 of the Internal Revenue Code.

(f) Credit against tax. In the case of a citizen, the tax shall be reduced by the amount of any credit allowed by section 296 of the Internal Revenue Code.

(g) Allowance of deduction. In the case of a citizen, the tax shall be reduced by the amount of any deduction allowed by section 297 of the Internal Revenue Code.

(h) Withholding at source. For withholding at source of tax on income from sources within the United States, see section 144.
Puerto Rican real estate not connected with his trade or business. In the first six months of 1942 he also derived $8,000 gross income from rental property located in the United States. He derived a like amount of gross income from such property during the last six months of 1942. He also derived $8,000 from Puerto Rican real estate, the profits derived were engaged in trade or business within the United States. The profits resulting from the sale of the property held during the space of 1942 and 1943 were not subject to the surtax imposed for the year ending June 30, 1933, and for other purposes.

§ 29.232-1 Status of citizens of United States possession. A citizen of a possession of the United States who is not otherwise a citizen of the United States is subject to the same income tax provisions of the Internal Revenue Code as if he were a nonresident alien individual. (See sections 211 to 219, inclusive.) For Federal income tax purposes the income tax provisions of the Internal Revenue Code apply to a corporation from all sources connected with income from sources within the United States whether or not any possession of the United States is a tax-paying corporation. The income tax provisions of the Internal Revenue Code are applicable to citizens of possessions of the United States who are engaged in trade or business within the United States and in trade or business within a possession of the United States, and to their corporations, partnerships, estates, and trusts, and to the income from sources within the United States or a domestic corporation entitled to relief from the tax as if he were a nonresident alien individual. (See sections 211 to 219, inclusive.)

The Act referred to in section 233 (b) provides that income tax laws then or thereafter in force in the United States shall apply to the Virgin Islands, but that the taxes shall be paid into the treasury of the Virgin Islands. Accordingly, persons are taxed there under the income tax provisions of the Internal Revenue Code.

CHINA TRADE ACT CORPORATION Sec. 233. Taxation of citizens. [as amended by sec. 154, Act of Oct. 23, 1933, 48 Stat. 688.] (a) Corporation tax. A corporation organized under the China Trade Act, 1933 (48 Stat. 684), shall be subject to tax under section 13 or section 14 (b), and under section 15.

(b) Cross reference. For inclusion in corporate returns of income, see section 13, or in shareholders' accounts see section 23.

§ 29.261-1 Tax on China Trade Act corporations. A China Trade Act cor-

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poration is, under section 261 (a), subject to the tax imposed by section 13 (b) if it has a normal-tax net income of more than $15,000 (see § 29.13-12), or to the tax provided by section 14 (b) if it has a normal-tax net income of not more than $25,000. Such a corporation is also subject to the surtax imposed by section 15 (see § 29.15-1).

SECOND COMPUTATION—ALLOWING SPECIAL CREDIT AGAINST NET INCOME

Net income $200,000

Since the total net income is derived from sources within China and since the par value of the shares of stock of the corporation owned on the last day of the taxable year by (1) persons resident in China, the United States, or possessions of the United States, and (2) individual citizens of the United States or China wherever resident, is 100 percent of the par value of the total number of shares of stock of the corporation outstanding on that day, 100 percent of the net income from sources within China is deductible as a special credit against net income.

Special credit against net income $200,000

Amount of income subject to tax under section 12 None

Since the special dividend ($85,000) exceeds the diminution of the tax ($50,000) on the par value of the shares of stock of the corporation, the whole of the special dividend is deductible. The total income tax is $80,000.

$29.15-1 Income of China Trade Act corporations. The items of gross income to be included in the return of a corporation organized under the China Trade Act and the deductions allowable are the same as in the case of other domestic corporations.

§ 29.15-2 Credits allowed China Trade Act corporations. In addition to the credits allowed under section 26 (a) and (b), a China Trade Act corporation may, of its own free will, allow an additional credit for the purpose of computing the taxes imposed by section 13 or 14, by section 15, and by section 600. This credit is an amount equal to the proportion of the net income derived from sources within China (determined in a similar manner to that provided in section 119) which is deductible as a special credit against net income.

Example. The A Company, a China Trade Act corporation, has a net income for the calendar year 1942 of $200,000 and receives a dividend from a domestic corporation. All of its stock on December 31, 1942, is owned on that date by persons resident in China, the United States, or individual citizens of the United States, or persons resident in China, the United States, or individual citizens of the United States, or citizens of China, the United States, or possession of the United States or China. The declared value of the capital stock tax return for the capital stock tax year ended June 30, 1943 (10 percent of $1,500,000) $150,000.

Net income subject to declared value excess-profits tax $50,000

Less: Amount taxable at 10 percent of the declared value excess-profits tax $50,000

Amount taxable at 10 percent $50,000

Declared value excess-profits tax at 10 percent (6 percent of $50,000) $3,000

SECOND COMPUTATION—ALLOWING SPECIAL CREDIT AGAINST NET INCOME

Net income $200,000

Since the total net income is derived from sources within China and since the par value of the shares of stock of the corporation owned on the last day of the taxable year by (1) persons resident in China, the United States, or possessions of the United States, and (2) individual citizens of the United States or China wherever resident, is 100 percent of the par value of the total number of shares of stock of the corporation outstanding on that day, 100 percent of the net income from sources within China is deductible as a special credit against net income.

Special credit against net income $200,000

Amount of income subject to declared value excess-profits tax None

Since the special dividend ($85,000) exceeds the diminution of the tax ($50,000) on the par value of the shares of stock of the corporation, the whole of the special dividend is deductible. The total income tax is $80,000.
Since the diminution of the declared value excess-profit tax ($9,000) on account of the dividends not includable does not exceed the amount by which, the special dividend ($85,000) exceeds the diminution of the income tax ($900,000) on account of such credit, the entire amount of the special credit ($250,000) is allowable and the corporate excess profit value excess-profit tax liability for 1942.

§ 29.262-3 Meaning of terms used in connection with China Trade corporation. A China Trade corporation under the provisions of the China Trade Act, 1922, shall not be allowed the credits against the tax for taxes of foreign countries and possessions of the United States allowed by the laws of the United States, beginning December 31, 1941, for the purpose of exclusion of dividends from gross income, see section 110. 

ASSESSMENT AND COLLECTION OF DEFICIENCIES

§ 271. Definition of deficiency. As used in this chapter in respect of a tax imposed by this chapter “deficiency” means—(a) the amount by which the tax imposed by this chapter exceeds the amount shown as the tax by the return; or the amount shown on the return shall first be increased by the amounts previously assessed (or collected without assessment) as a deficiency, and the amount so increased, shall be assessed as a deficiency, and the amount previously abated, credited, refunded, or otherwise repaid in respect of such tax; or (b) if no amount is paid to the taxpayer upon his return, or if no return is made by the taxpayer, then the amount by which the tax imposed by this chapter is not assessed (or collected without assessment) as a deficiency; but such amounts previously assessed, or collected without assessment, shall be deducted from such amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax.

§ 271-1 Deficiency defined. Section 271 by its definition of the word “deficiency” provides a term which will apply to any amount of tax determined to be due in respect of a taxable year in excess of the amount of tax reported by the taxpayer for such year; or in excess of the amount reported by the taxpayer after adjusting for any allowances, abatements, credits, refunds, or collections without assessment. In defining the term “deficiency” section 271 recognizes two classes of cases, where the tax is determined in the manner showing correct tax liability; the other, where the taxpayer makes a return showing no tax liability, or where the taxpayer fails to make a return. Additional tax shown on an “amended return,” so called, is a deficiency within the meaning of the Internal Revenue Code.

When a case is considered for the first time, the amount is the excess of the amount determined to be the correct amount of the tax over the amount shown as the tax by the taxpayer on his return, or, if it is a case where no tax was reported, the deficiency is the amount determined to be the correct amount of the tax. Subsequent information sometimes discloses that the amount previously determined to be the correct amount of the tax is less than the correct amount of the tax. In such a case the deficiency on readetermination is the excess of the amount determined to be the correct amount of the tax over the sum of the amount of tax reported by the taxpayer and the deficiency assessed in connection with the previous determination. If it is a case where no tax was reported, the deficiency is the excess of the amount determined to be the correct amount of the tax over the amount of the deficiency determined in the previous determination. If the previous determination resulted in a credit or refund to the taxpayer, the deficiency upon the second determination is the excess of the amount determined to be the correct amount of the tax over the amount of the tax reported by the taxpayer decreased by the amount of the credit or refund.

§ 272. Procedure in general. As amended by section 163 (c), Rev. Act 1942. (1) Petition by taxpayer. If in the case of any taxpayer the Commissioner determines that there is a deficiency in respect of any tax, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail, within thirty days after such notice is mailed (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day), the taxpayer may file a petition in the Tax Court of the United States for a redetermination of the deficiency. Notice of assessment for such year shall be deemed an “assessment” in respect of the tax imposed by this chapter and no subsequent or proceeding in court for its collection shall be made, begun, or proceeded upon, unless a petition has been mailed to the taxpayer, nor until the expiration of such ninety-day period, nor, if a petition has been filed, unless the Board, before the decision of the Board has become final. Notwithstanding the provisions of section 2923 of this chapter or the beginning of such proceeding or of such proceeding during the time such prohibition is in force may be enjoined by a proceeding in the proper court. In the case of a joint return filed by husband and wife such notice of deficiency may be a single joint notice, except that if the Commissioner has been notified by either spouse that separate residences have been established, then, in lieu of the single joint notice, separate notices must be mailed to each spouse at his last known address. If the notice is addressed to a person outside the districts of the United States and of the District of Columbia, the period specified in this paragraph shall be one hundred and fifty days in lieu of ninety days.

(c) Cross reference. For exceptions to the restrictions imposed by this subsection, see subsection (d) of this section, relating to waivers by the taxpayer.

Subsection (f) of this section, relating to notifications of mathematical errors appearing upon the face of the return; Section 273, relating to jeopardy assessments; Section 274, relating to bankruptcy and reorganizations; and Section 1145, relating to assessment or collection of the amount of the deficiency determined by the Board, do not apply.

(b) Collection of deficiency by Board. If the taxpayer files a petition with the Board, the amount determined as the deficiency by the decision of the Board which has become final shall be assessed and shall be paid upon notice and demand from the Board. No part of the deficiency shall be determined as a deficiency by the Commissioner but disallowed as such by the decision of the Board which has become final shall be assessed and collected and the Board may proceed in court with or without assessment.

(c) Failure to file petition. If the taxpayer does not file a petition with the Board within
the time prescribed in subsection (a) of this section, the deficiency, notice of which has been mailed, shall be assessed, and shall be paid upon notice and demand from the collector.

(c) Notice of deficiency. The taxpayer shall at any time have the right, by a signed notice in writing filed with the Commissioner, to waive the restrictions provided in subsection (a) of this section on the assessment and collection of the whole or any part of the deficiency.

(d) Determination of deficiency after notice mailed. The Board shall have jurisdiction to redetermine the correct amount of the deficiency even if the amount so redetermined is greater than the deficiency, notice of which has been mailed to the taxpayer, and to determine whether any penalty, additional amount or addition to the tax should be assessed—when claim therefor is asserted by the Commissioner at or before the hearing or appeal.

(e) Further deficiency letters restricted. If the Commissioner has mailed to the taxpayer a notice of a deficiency as provided in subsection (a) of this section, and the taxpayer files a petition with the Board within the time prescribed in such subsection, the Commissioner shall have no right to issue any additional deficiency in respect of the same taxable year, except in the case of fraud, or of neglect to file a return, or of absence of notice to the Commissioner under section 312 (a) of the existence of a fiduciary relationship, notice of a deficiency in respect of which is mailed, or of section 272 (c), prohibiting credits or refunds after petition to the Board.

(f) Jurisdiction over other taxable years. The Board in redetermining a deficiency in respect of any other taxable year, shall at any time have the right, by a signed notice in writing filed with the Board, to redetermine the amount and collection of the whole or any part of the deficiency.

(g) Final decisions of Board. For the purposes of this chapter the date on which a decision of the Board becomes final shall be determined according to the provisions of section 1140.

(h) Prorating of deficiency to installment. If the taxpayer fails to pay an installment of a deficiency and a deficiency has been assessed, the deficiency shall be prorated to the taxpayer on the date that payment was due. Except as provided in section 273 (relating to jeopardy assessments), that part of the deficiency so prorated to any installment the date for payment of which has not arrived, shall be paid upon notice and demand from the collector.

(i) Extensions of time for payment of deficiencies. Where it is shown to the satisfaction of the Commissioner that the payment of a deficiency upon the date prescribed in such deficiency will result in undue hardship to the taxpayer, the Commissioner, under regulations prescribed by the Commissioner, with the approval of the Secretary, may grant an extension of time for payment of such deficiency for a period not in excess of eighteen months, and, in exceptional cases, for a further period not in excess of twenty-four months. If an extension is granted, the Commissioner may require the taxpayer to furnish a bond in such amount, not exceeding double the amount of the deficiency, and with such sureties, as the Commissioner deems necessary, conditioned upon the taxpayer's refunding the deficiency, and paying any additional amount or addition to the tax, with the terms of the extension. No extension shall be granted if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

(j) Address for notice of deficiency. In the absence of notice to the Commissioner under section 312 (a) of the existence of a fiduciary relationship, notice of a deficiency in respect of which is mailed, or is under a legal disability, or, in the case of a corporation, has terminated its existence, such notice shall be sufficient for the purposes of this chapter even if such taxpayer is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence.

§ 29.272-1. Assessment of a deficiency. If the Commissioner determines that there is a deficiency in respect of the tax imposed by sections 272 and 273 (a), the Commissioner is authorized to notify the taxpayer of the deficiency by registered mail. If a joint return has been filed by husband and wife, the Commissioner may, unless he has been notified by either spouse that a separate residence has been established, send either a joint or separate notice of a deficiency, that is, a duplicate original of the joint notice, must be sent by registered mail to each spouse at his or her last known address. The notice to the Commissioner provided for in section 272 (a), relating to separate residences, should be addressed to the Commissioner of Internal Revenue, Washington, D.C. for the attention of the interest Division. Within 90 days after notice of the deficiency is mailed (or within 150 days after mailing in the case of such a notice mailed after October 21, 1942, and addressed to the interest Division of the United and the District of Columbia), as provided in section 272 (a), a petition may be filed with The Tax Court of the United States for a redetermination of the deficiency. In determining such 90-day or 150-day period, Saturday, Sunday, legal holiday, shall be considered to be part of the period; and if a deficiency is mailed after October 21, 1942, and addressed to the interest Division of the United and the District of Columbia, the period shall be extended 30 days. The filing of such notice with The Tax Court shall be sufficient for the purposes of this chapter even if such taxpayer is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence.

§ 29.272-2. Waiver of restrictions. If the Commissioner determines that the payment of a deficiency is immediately jeopardized by delay, such deficiency shall be assessed immediately, irrespective of the provisions of section 1145.

(a) If a taxpayer is notified of an additional amount or addition to the tax due on account of a deficiency in respect of the tax imposed by sections 272, 273 (a), (c), (e), (g), and 274, and an assessment of the whole or any part of the deficiency is made or jeopardy, the Board shall have jurisdiction to reduce the deficiency in respect of the tax imposed by sections 272, 273 (a), (c), (e), (g), and 274, or to determine whether any penalty, additional amount or addition to the tax shall be assessed, or to redetermine the correct amount of the deficiency.

(b) If the Commissioner believes that the assessment or collection of a deficiency will be jeopardized by delay, such deficiency shall be assessed immediately, irrespective of the provisions of section 1145.

(c) Upon the adjudication of bankruptcy or the appointment of a receiver for any taxpayer in any receivership proceeding before any court of the United States or of any State or Territory or of the District of Columbia, any deficiency determined by the Commissioner in respect of the tax shall be assessed immediately, irrespective of the provisions of section 1145.

(d) If The Tax Court renders a decision and determines that there is a deficiency, and, if the taxpayer duly files a petition for review of the decision by a circuit court of appeals (see sections 251 and 252 of the United States Court of Appeals for the District of Columbia), the filing of the petition will not operate as a stay of the assessment of any portion of the deficiency determined by the Commissioner unless he has filed a bond with The Tax Court as provided in section 1145. In such a case the necessary bond has not been filed. If a petition for review is filed, the amount determined by The Tax Court as the deficiency will be assessed immediately after the filing of such petition.

(e) If the Commissioner files a petition for review and (1) (a) (a) the taxpayer has not filed a petition for review within three months after the decision of The Tax Court is rendered, or (b) if such petition is filed and the necessary bond has been filed, but the necessary bond referred to in section 1145 has not been filed with The Tax Court on or before the time his petition for review is filed, the amount determined by The Tax Court as the deficiency will be assessed in the case of (a) immediately after the expiration of the 3-month period, and in the case of (b) immediately after the filing of the petition for review with the taxpayer, that the Commissioner waive the restrictions on the assessment of tax whole or any part of the deficiency. The Board may not act. If any petition is filed with the Commissioner, the filing of such notice with The Tax Court does not constitute filing with the Commissioner or with the Tax Court, and, until the petition with The Tax Court becomes final, section 1140.

(f) The taxpayer may at any time by a signed notice in writing filed with the Commissioner waive the restrictions on the assessment of tax whole or any part of the deficiency. The Board may not act. If any petition is filed with the Commissioner, the filing of such notice with The Tax Court does not constitute filing with the Commissioner or with the Tax Court, and, until the petition with The Tax Court becomes final, section 1140.

(g) If a petition is filed with The Tax Court, the taxpayer should notify the Commissioner that the petition has been filed. In order to prevent an assessment by the Commissioner of the amount determined to be the deficiency. If no petition is filed with The Tax Court.
within the period prescribed, the Commissioner shall assess the amount determined by him as the deficiency and of which he has notified the taxpayer by registered mail. If the Commissioner will not be precluded from determining a further deficiency and notifying the taxpayer thereof by registered mail, where a petition is filed with the Tax Court within 30 days, it will be determined as the deficiency by the decision of the Tax Court which has become final shall be assessed by the Commissioner. If the Commissioner mails to the taxpayer notice of a deficiency, and the taxpayer files a petition with The Tax Court within the prescribed period, the Commissioner is barred from determining any additional deficiency for the taxable year except in the case of fraud and except as provided in section 272 (e) relating to the assertion of greater deficiencies before The Tax Court or in section 273 relating to jeopardy assessments.

§ 29.372-2 Collection of a deficiency. Where a deficiency as redetermined by a decision of The Tax Court which has become final is assessed, or where the taxpayer has not filed a petition with the Tax Court within the prescribed period, the Commissioner has been assessed, the amount so assessed shall be paid upon notice and demand from the collector. As to cases coming within the provisions of paragraphs (b), (c), and (d) of § 29.372-1, see sections 273 (i) and 273 and section 1145. As to interest on deficiencies, see section 292.

§ 29.372-3 Extension of time for payment of a deficiency. If it is shown to the satisfaction of the Commissioner that the payment of a deficiency upon the date or dates prescribed for the payment thereof will result in undue hardship to the taxpayer, the Commissioner may grant an extension of time for the payment of the deficiency or any part thereof for a period not in excess of 18 months, and in exceptional cases for a further period not in excess of 12 months. The extension shall be granted upon general statement of hardship. The term "undue hardship" means more than an inconvenience to the taxpayer. It must appear that substantial financial loss, for example, due to the sale of property at a sacrifice price, will result to the taxpayer from making payment of the deficiency at the due date. If a market exists, the sale of property at the current market price is not ordinarily considered as resulting in an undue hardship. The Internal Revenue Code provides that no extension will be granted where there is negligence or intentional disregard of rules and regulations or to fraud with intent to evade tax.

An application for an extension of time for the payment of a deficiency should be made under oath on Form 1127 and must be accompanied or supported by evidence showing the undue hardship that the taxpayer would suffer if the extension were refused. A sworn statement of assets and liabilities of the taxpayer and an itemized statement under oath showing all receipts and disbursements for each of the three months immediately preceding the month in which falls the date prescribed for the payment of the deficiency are required and should accompany the application. If the evidence, must be filed with the collector, who will transmit it to the Commissioner with his recommendations as to the extension. When it is received by the Commissioner, it will be examined and, if possible, within 30 days will be denied, granted, or tentatively granted subject to certain conditions of which the taxpayer will be notified. The Commissioner may require an application for an extension of time for the payment of a deficiency unless request therefor is made to the collector on or before the date prescribed for payment thereof, as shown by the demand for payment from the collector, or on or before the date or dates prescribed for payment in any prior extension granted.

As a condition of such an extension, the Commissioner will usually require the taxpayer to furnish a bond on Form 1127 or in an amount not exceeding double the amount of the deficiency or any part thereof. The bond shall be conditioned on the payment of the liability on or before the date or dates prescribed for payment in the extension, so that the risk of loss to the Government is greater at the end of the extension period than it was at the beginning of the period. If a bond is required it shall be conditioned upon the payment of the deficiency, interest, and penalties, and such sureties in connection therewith in accordance with the terms of the extension granted, and shall be executed by a surety company holding a certificate of authority from the Secretary of the Treasury as an acceptable surety on Federal bonds, and shall be subject to the approval of the Commissioner. In lieu of such a bond, the taxpayer may file a bond or security covering the whole of the United States as provided in section 1128 of the Revenue Act of 1926. The amount of the deficiency and additions thereto shall be paid to the collector on or before the expiration of the period of the extension without the necessity of notice and demand from the collector. Payment of the deficiency and additions thereto before the expiration of the extension will not relieve the taxpayer from paying the entire amount of interest provided for in the extension. (See section 290.)

SEC. 273. JUDGMENT ACCREMENTS.

(a) Authority for making. If the Commissioner believes that the collection or collection of a deficiency will be jeopardized by delay, he shall immediately make such demand, together with all interest, additional amounts, or additions to the tax provided for by law) and notice and demand shall be made by the collector for the payment thereof.

(b) Deficiency before. If the jeopardy assessment is made before any notice in respect of the tax to which the jeopardy assessment relates has been mailed under section 273 (a), then the Commissioner shall mail a notice under such subsection within thirty days after the mailing of the assessment.

(c) Amount assessable before decision of Board. The jeopardy assessment may be made in respect of a deficiency greater than that notice of which has been mailed to the taxpayer, despite the provisions of section 272 (d) prohibiting determination of additional deficiencies, and whether or not the taxpayer has theretofore filed a petition with the Board of Tax Appeals of the United States. The Commissioner may, at any time before the decision of the Board is rendered, through a jeopardy assessment, determine an addition, or state that he believes the assessment to be excessive in amount. The Commissioner shall not be required to determine an addition, or state that he believes the assessment to be excessive in amount, if the petitioner is entitled to the amount of such assessment, or statement, if the petition is filed with the Board before the mailing of the assessment or is subsequently filed, and the taxpayer demonstrates that he is entitled to such assessment, or statement, in order to determine the entire amount of the deficiency and of all amounts assessed, if any, on the date of the jeopardy assessment, or statement.

(d) Amount assessable after decision of Board. If the jeopardy assessment is made after the decision of the Board is rendered, the bond shall, at the request of the taxpayer, be proportionately reduced. (e) Prejudgment interest. If the bond is given before the taxpayer has filed his petition with the Board and under section 272 (a) the bond shall contain a further condition that if a petition is not filed within the period provided in subsection (a) of section 272 (a) the amount of the collection which is stayed by the bond shall be paid on notice and demand made on the date of the jeopardy notice and demanded to the extent of notice and demand under this subsection.

(f) Waiver of delay. If the bond collection of the part of the amount assessed as is covered by the bond shall be stayed. The taxpayer shall have the right to contest such stay at any time in respect of the whole or any part of the amount covered by the bond, and if as a result of such waiver any part of the amount covered by the bond paid, the amount of the bond at the request of the taxpayer, be proportionately reduced. If the Board determines that the amount assessed which should have been paid, then when the decision of the Board is rendered the bond shall, as the case may be, be proportionately reduced.

(1) Collection of unpaid amounts. When the petition has been filed with the Board and the amount which has been assessed has been determined by a decision of the Board which has become final, then any unpaid portion of which has been stayed by the bond, shall be collected as part of the tax upon notice and demand from the collector, and any remain-
petition of the taxpayer is filed with The Tax Court, either before or after the decision of The Tax Court is rendered, abate such assessment. Regardless of whether the taxpayer has been assessed, if the amount determined as the amount which should have been assessed is greater than the amount actually assessed, then the deficiency shall be assessed and shall be collected as part of the tax upon notice and demand from the collector.

(i) Claims in abatement. No claim in abatement shall be filed in respect of any assessment in respect of any tax imposed by this chapter.

29.273-1 Jeopardy assessments. If the Commissioner believes that the assessment or any unpaid portion thereof, to be jeopardized, the assessment may be made only after the deficiency determined as the amount of the deficiency is assessed on account of jeopardy after the decision of The Tax Court of the United States is rendered, the jeopardy assessment may be made only with respect to the deficiency determined by The Tax Court. The Commissioner is prohibited from making a jeopardy assessment after a decision of The Tax Court has become final (see section 1140), or after the taxpayer has filed a petition for review of the decision of The Tax Court.

If notice of a deficiency was mailed to the taxpayer (see section 272 (a)) before it was discovered that delay would jeopardize the assessment or collection of the tax, a jeopardy assessment may be made in an amount greater or less than that included in the deficiency notice. On the other hand, if the assessment on account of jeopardy was made without mailing the notice required by section 272 (a), the Commissioner must within 60 days after the mailing of the assessment send the taxpayer notice of the deficiency by registered mail. The taxpayer may file a petition with The Tax Court for a redetermination of the amount of such deficiency. If notice is mailed within 150 days after mailing in the case of such a notice mailed after October 21, 1942, and addressed to a person outside the States of the United States (or of the District of Columbia), not counting Sunday or a legal holiday in the District of Columbia as the ninetieth or one hundred fifteenth day. The Commissioner may, at any time before the decision of The Tax Court is rendered, abate such assessment, or any unpaid portion thereof, to the extent that he believes the assessment to be unjustified. If the petition of the taxpayer is filed with The Tax Court, either before or after the making of the jeopardy assessment, the Commissioner is required to notify The Tax Court of the existence of such a petition, and The Tax Court has jurisdiction to redetermine the amount of the deficiency together with all other amounts assessed at the same time in connection therewith. See section 272 (c).

After a jeopardy assessment has been made, the list showing such assessment will be immediately transmitted to the collector. Upon receipt of the list containing the assessment, the collector is required to send notice and demand to the taxpayer for the amount of the jeopardy assessment. Regardless of whether the taxpayer has been assessed, if the assessment has been stayed by The Tax Court, unless before the expiration of such 10-day period he files with the collector a bond on Form 1439 of the character hereinafter prescribed. The bond must be in such an amount as will enable the collector to demand the amount for which the stay is desired, as the collector deems necessary and must be executed by sureties satisfactory to the collector. It must be conditioned upon the payment of such amount. The amount included therein as is not abated by a decision of The Tax Court which has become final, together with the interest thereon at the rate of 6 percent per annum from the date of the deficiency and demand to the date of the notice and demand made after the expiration of the 90-day or 150-day period provided for the filing of such petition, the amount stayed by the bond will be paid upon notice and demand at any time after the expiration of the period prescribed for filing such petition. If the amount of the jeopardy assessment is in excess of the amount determined by The Tax Court, the unpaid portion of such excess will be abated. If any part of the excess amount has been paid, it will be credited or refunded to the taxpayer as provided in section 322.

As to bankruptcy proceedings for the relief of debtors and receivership cases, see sections 274 and 278 and §§ 29.274-1 and 29.274-2.

SEC. 274. BANKRUPTCY AND RECEIVERSHIPS.

(a) Immediate assessment. Upon the adjudication of bankruptcy of any taxpayer in any bankruptcy proceeding or in the appointment of a receiver for any taxpayer in any receivership proceeding before any court of the United States or of any State or Territory or of the District of Columbia, any deficiency (together with all interest, additional amounts, and amounts added for law) determined by The Tax Court determined by the Commissioner in respect of a tax imposed by this chapter upon such taxpayer shall, despite the restrictions imposed by sections 292, 293, and 294 and 29.274-2, be immediately assessed if such deficiency has not theretofore been assessed in accordance with law. In such cases the trustee in bankruptcy or receiver shall give notice in writing to the Commissioner of the adjudication of bankruptcy or the appointment of the receiver, and the running of the statute of limitations on the making of assessments shall be suspended for the period from the date of the adjudication in bankruptcy or the appointment of the receiver to a date 90 days after the date upon which the notice of the receiver or the receiver was received by the Commissioner; but the suspension under this sentence shall in no case be for a period in excess of two years. Claims for the deficiency and such interest, additional amounts and additions to the tax may be asserted, for adjudication in accordance with law, to the court before which the bankruptcy or receivership proceeding is pending, despite the pendency of proceedings for the redetermination of the deficiency in pursuance of a petition to the Board [known as The Tax Court of the United States]; but no petition for a stay of collection shall be filed with the Board after the adjudication of bankruptcy or the appointment of the receiver.
Unpaid claims. Any portion of the claim allowed in bankruptcy or receivership proceeding which is unpaid shall be paid by the taxpayer upon notice and demand within three years after the termination of such proceeding, and may be collected by distraint or proceeding in court within six years after termination of such proceeding. Extensions of time for such payment may be had in the same manner and subject to the same provisions and limitations as are provided in section 274 (1) and section 280 in the case of a deficiency in a tax imposed by this chapter.

§ 29.274-1 Bankruptcy and receivership proceedings. During a bankruptcy or receivership proceeding in either a Federal or a State court, the assets of the taxpayer are in general under the control of the court in which such proceeding is pending, and the collection of taxes cannot be made by distraint upon such assets. However, any assets which under applicable provisions of law are not under the control of the court may be subject to distraint.

As used in these regulations the term "bankruptcy proceeding" includes proceedings under Chapters I to VII of the Bankruptcy Act, as amended, and section 102, 76, 77, 78, 79, 80, 86, or 87, or Chapters XI to XIII, or Chapter XV, of such Act, as amended; and the term "judication of bankruptcy" includes, in addition to an adjudication providing for the liquidation of the estate of the bankrupt in a bankruptcy proceeding in either a Federal or a State court, the appointment of a receiver, trustee, debtor in possession, or other person designated as in control of the assets of the debtor by the court in which bankruptcy or receivership proceeding is pending, or within six years after the termination of such proceeding.

A trustee in bankruptcy (including a trustee, receiver, debtor in possession, or other person designated as in control of the assets of a debtor in any bankruptcy proceeding by order of the court in which such proceeding is pending) or a receiver in any receivership proceeding is required in writing to the Commissioner of Internal Revenue in Washington, D. C., of the adjudication or the appointment of a receiver. See section 274 (a) and § 29.274-1.1.)

Collectors should, promptly after notice of outstanding liability against a taxpayer in any bankruptcy or receivership proceeding, and in any event within the time limited by the appropriate provisions of the Bankruptcy Act, as amended, and the orders of the court in which such proceeding is pending, file claims covering such liability in the court in which such proceeding is pending. Such claim should be filed whether the unpaid taxes involved have been assessed or not, except in cases where the departments direct otherwise; for example, where the payment of the taxes is secured by a sufficient bond. Such claims should cover the amount represented by the assessment, plus interest at the rate of 6 percent per annum for the period from the date of filing claim by the collector to the date of termination of the bankruptcy or receivership proceeding or to the date payment is made in full prior to such termination. At the same time claim is filed with the bankruptcy or receivership court, the collector will send notice and demand for payment to the taxpayer together with a copy of such claim.

Under section 3466 of the Revised Statutes and section 3467 of the Revised Statutes, as amended, and section 64 of the Bankruptcy Act, as amended, taxes are entitled to the priority over other claims that remain unsatisfied. A debtor, trustee, receiver, debtor in possession, or other person designated as in control of the assets of the debtor by the court in which bankruptcy or receivership proceeding is pending, or within six years after the termination of such proceeding, notifying him in detail how the deficiency was computed, that he may furnish evidence showing wherein the deficiency is incorrect, and that upon request he will be granted a hearing with respect to such deficiency. If after such evidence is submitted and hearing held any adjustment appears necessary in the deficiency, appropriate action will be taken. A copy of the notification letter will be attached to the assessment list as the collector's authority for filing claim in any bankruptcy or receivership proceeding.

If any portion of the claim allowed by the court in a bankruptcy or receivership proceeding remains unpaid after the termination of such proceeding, the collector will send notice and demand for payment thereof to the taxpayer. Such unpaid portion with interest as provided in section 298 may be collected from the taxpayer by distraint or proceeding in court within six years after the termination of the bankruptcy or receivership proceeding. Extensions of time for the payment of such unpaid amount may be granted in the same manner and subject to the same provisions and limitations as provided in sections 274 (1) and 297. (See § 29.272-3.)

This section deals only with immediate assessments provided for in section 274 and the procedure in connection with such assessments.

SEC. 275. PERIOD OF LIMITATION UPON ASSERTMENT AND COLLECTION [as amended by Code 1943, 2d Rev. Act 1940].

Except as provided in section 276—

(a) General rule. The amount of income taxes imposed by this chapter shall be asserted and collected in the manner and with the rights provided for herein, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

(b) Request for prompt assessment. In the case of income received during the lifetime of a decedent, or by his estate during the period of administration, or by a corporation, the tax shall be assessed, and any proceeding in court without assessment for the collection of such tax shall be begun, within eighteen months after written request therefor (filed after the return is mailed by the executor, administrator, or other fiduciary representing the estate of such decedent, or by the corporation, but not after the expiration of three years after the return was filed). This subsection shall not apply in the case of estates or corporations.

(1) Such written request notifies the Commissioner that the corporation contemplates dissolution at or before the expiration of such 18 months' period.

(2) The dissolution is in good faith begun before the expiration of such 18 months' period.

(3) The dissolution is completed.

(c) Assessment from gross income. If the taxpayer omits from gross income an amount properly includible therein which is In excess of 25 percent of the amount of gross income.
Income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within seven years after the return was filed.

(d) **Constructive dividends.** If the taxpayer omits from gross income an amount properly includible therein—

(1) **Foreign personal-holding companies.** Under section 394 (relating to the inclusion in the gross income of United States shareholders of their distributive share of the undistributed Supplement P net income of a foreign personal-holding company); or

(2) **Personal service corporations.** Under section 394 (b) (relating to the inclusion in the gross income of their distributive shares of undistributed Supplement S net income of a personal service corporation):

the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within seven years after the return was filed.

(e) **Distributions in liquidation to shareholders.** If the taxpayer omits from gross income an amount properly includible therein under section 301 (c) (relating to liquidation in liquidation of a corporation, other than a foreign personal holding company, the tax must be assessed, or a proceeding in court for the collection of such tax, may be begun without assessment, at any time within four years after the return was filed.

(f) For the purposes of subsections (a), (b), (c), and (d), a return filed before the last day prescribed by law for filing thereof shall be considered as filed on such last day.

(g) **Corporation and shareholder.** If a corporation makes no return of the tax imposed by this chapter, but each of the shareholders, includes in income the distributive share of the net income of the corporation, then the tax of the corporation shall be assessed within four years after the last date on which any such shareholder's return was filed.

**S. 276. SAME: EXCEPTIONS.**

(a) **False return or no return.** In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

(b) **Waiver.** Where before the expiration of the time prescribed for payment of the tax an assessment is made for the purpose of any adjustment or determination of any deficiency, the taxpayer may request the commissioner of internal revenue to extend the regular period of limitations of any deficiency for the period during which such deficiency is assessed. Such a request does not have the effect of extending the regular period of limitation of any deficiency assessed at any time prior to the expiration of the period previously agreed upon.

(c) **Collection after assessment.** Where the assessment of any income tax imposed by this chapter has been made within the period of limitation properly applicable thereto, such tax may be collected by distraint or by a proceeding in court, but only if begun (1) within six years after the assessment of the tax, or (2) within six months after the expiration of the period for collection agreed upon in writing by the commissioner and the taxpayer before the expiration of such six-year period. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

**S. 277. SUSPENSION OF RUNNING OF LIMITATION.**

The running of the statute of limitations provided in section 275 or 278 on the making of assessments and the beginning of distraint or a court proceeding, in respect of any deficiency, shall (after the mailing of a notice under section 272 (a)) be suspended for the period during which the Commissioner, or his delegate as the case may be, is prevented from making the assessment or beginning distraint or proceeding in any event, if a proceeding in respect of the deficiency is received by any court or other person as the case may be, and the taxpayer does not appeal therefrom to a higher court or proceeding; provided, that if the period of such suspension is for a period in excess of two years, the taxpayer may, at any time prior to the expiration of the period so extended, request the Commissioner to extend the running of the statute of limitation of any deficiency for the period during which such deficiency is assessed. Such a request does not have the effect of extending the regular period of limitation of any deficiency assessed at any time prior to the expiration of the period previously agreed upon.

(d) In the case of a false or fraudulent return with intent to evade tax, the tax may be assessed at any time within five years after the return was filed.

(e) In the event the taxpayer fails to file a return, the amount of tax due may be assessed at any time after the date prescribed for filing the return.

(f) If the taxpayer omits from gross income an amount properly includible therein under section 394 (b) as his distributive share of the Supplement S net income of a personal service corporation, the tax may be assessed at any time within seven years after the return was filed.

(g) If the taxpayer omits from gross income an amount properly includible therein under section 115 (e) as an amount distributed in liquidation of a corporation, other than a foreign personal holding company, the tax may be assessed at any time within four years after the return was filed.

(h) If before the expiration of the time prescribed in section 275 for the assessment of the tax the Commissioner and the taxpayer agree in writing to extend for the period of limitation the assessment or any proceeding in court (and in any event, if a proceeding in respect of the deficiency is placed on the docket of the United States Tax Court, the notice of deficiency so stated, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

(i) If a notice of a deficiency has been mailed to the taxpayer under the provisions of section 272 (a), then the running of the statute of limitations on assessment of any deficiency shall be suspended for the period during which the Commissioner is prohibited from making the assessment and beginning distraint and proceeding in any event, if a proceeding in respect of the deficiency is placed on the docket of the Board (known as the Tax Court of the United States). The tax shall be assessed within six years after the return was filed.

(j) In a bankruptcy or receivership proceeding the running of the statute of limitations on assessment of any deficiency is suspended from the date of adjudication in bankruptcy or the date of the appointment of a receiver, as the case may be, to a date 30 days after the date upon which a notice of deficiency (a) section 274 (a) is received by the Commissioner in Washington, D. C., but in no case shall the suspension be for a period in excess of two years. See paragraphs 274 (a) and 284. See paragraph 297 of the Code.

(k) With respect to the period of limitation for assessing the amount of the liability of a transferee of property, or for assessing the amount of the liability of a fidu-
In any case in which the tax has been assessed within the statutory period of limitation properly applicable thereto, a proceeding in court or distraint for the collection of such tax may be begun within six years from the date of the failure thereof, or prior to the expiration of any period for collection agreed upon in writing by the Commissioner and the taxpayer before the expiration of such period agreed upon, or may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon. In determining the running of the statute of limitations in respect of distraint, the distraint shall be held to have been begun, in the case of personal property, on the date on which the levy upon such property is made, or, in the case of real property, on the date on which notice of the time and place of sale is given to the person whose estate it is proposed to sell.

If a notice of deficiency has been mailed to the taxpayer under the provisions of section 272 (a) (see § 29.272-1), then the running of the statute of limitations on the beginning of distraint after assessment, or on the beginning of a proceeding in court without assessment, in respect of any deficiency, shall be suspended for the period during which the Commissioner is prohibited from beginning such distraint or proceeding in court (and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Tax Court of the United States, until the decision of the Tax Court (or the Board becomes final), and for 60 days thereafter.

With respect to the period of limitation upon the collection of the tax on unpaid claims in bankruptcy or receiver proceedings, see section 274 (b) and § 29.274-2.

**Interest and additions to the tax**

**Sec. 294. Failure to file return (as amended by sec. 173 (f), Rev. Act 1912).**

(a) In case of any failure to make and file return or to pay the tax within the time prescribed by law or by the Commissioner in pursuance of law, unless it is shown that the failure was due to reasonable cause and not due to willful neglect, there shall be added to the tax: 5 per cent if the failure is for not more than thirty days with an additional 5 per cent for each additional thirty days or fraction thereof during which such failure continues, not exceeding 25 per cent in the aggregate.

The amount to be added to any tax shall be collected at the rate of 6 per cent per annum from the date of the deficiency, and from the date of the failure to pay the tax, at the rate of 5 per cent per annum (from the date prescribed for the payment of the tax), or from the date prescribed for the payment of the first installment thereof, to the date the deficiency is assessed or the date the tax is paid, whichever is the later. The interest or the additions to the tax shall be collected, and in the case of a deficiency due to failure to file a return, or in the case of a false or fraudulent return, or in the case of a deficiency due to fraud with intent to evade tax, see section 903. As to the making of returns for taxpayers by collector or the Commissioner, or the taxpayer exercising ordinary business care and prudence and was nevertheless unable to file the return within the prescribed time, or in the case of a false or fraudulent return, or in the case of a deficiency due to fraud with intent to evade tax, see section 294.

**Sec. 295. Interest on deficiencies.**

Interest upon the amount determined as a deficiency shall be assessed at the same time as the deficiency, shall be paid upon notice and demand from the collector, and shall be collected as a part of the tax, at the rate of 6 per cent per annum from the date prescribed for the payment of the tax, or 5 per cent from the date prescribed for the payment of the first installment thereof, to the date the deficiency is assessed or the date the tax is paid, whichever is the later.

(b) Fraud. If any part of any deficiency is due to fraud, 5 per cent of the total amount of the deficiency (in addition to such deficiency) shall be assessed, collected, and paid in the same manner as if it were a deficiency, except that the provisions of section 272 (d), relating to the prorating of a deficiency, and of section 292, relating to interest on deficiencies, shall not be applicable.

**Sec. 296. Addition to the tax in case of deficiency.**

(a) Negligence. If any part of any deficiency is due to negligence, or intentional disregard of rules and regulations but without intent to defraud, 5 per cent of the total amount of the deficiency (in addition to such deficiency) shall be assessed, collected, and paid in the same manner as if it were a deficiency, except that the provisions of section 272 (d), relating to the prorating of a deficiency, and of section 292, relating to interest on deficiencies, shall not be applicable.

In any case in which the tax has been assessed within the statutory period of limitation properly applicable thereto, a proceeding in court or distraint for the collection of such tax may be begun within six years from the date of the failure thereof, or prior to the expiration of any period for collection agreed upon in writing by the Commissioner and the taxpayer before the expiration of such period agreed upon, or may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon. In determining the running of the statute of limitations in respect of distraint, the distraint shall be held to have been begun, in the case of personal property, on the date on which the levy upon such property is made, or, in the case of real property, on the date on which notice of the time and place of sale is given to the person whose estate it is proposed to sell.

If a notice of deficiency has been mailed to the taxpayer under the provisions of section 272 (a) (see § 29.272-1), then the running of the statute of limitations on the beginning of distraint after assessment, or on the beginning of a proceeding in court without assessment, in respect of any deficiency, shall be suspended for the period during which the Commissioner is prohibited from beginning such distraint or proceeding in court (and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Tax Court of the United States, until the decision of the Tax Court (or the Board becomes final), and for 60 days thereafter.

With respect to the period of limitation upon the collection of the tax on unpaid claims in bankruptcy or receiver proceedings, see section 274 (b) and § 29.274-2.

**Interest and additions to the tax**

**Sec. 294. Failure to file return (as amended by sec. 173 (f), Rev. Act 1912).**

(a) In case of any failure to make and file return or to pay the tax within the time prescribed by law or by the Commissioner in pursuance of law, unless it is shown that the failure was due to reasonable cause and not due to willful neglect, there shall be added to the tax: 5 per cent if the failure is for not more than thirty days with an additional 5 per cent for each additional thirty days or fraction thereof during which such failure continues, not exceeding 25 per cent in the aggregate.

The amount to be added to any tax shall be collected at the rate of 6 per cent per annum from the date of the deficiency, and from the date prescribed for the payment of the tax, at the rate of 5 per cent per annum (from the date prescribed for the payment of the first installment thereof), to the date the deficiency is assessed or the date the tax is paid, whichever is the later. The interest or the additions to the tax shall be collected, and in the case of a deficiency due to fraud with intent to evade tax, see section 903. As to the making of returns for taxpayers by collector or the Commissioner, or the taxpayer exercising ordinary business care and prudence and was nevertheless unable to file the return within the prescribed time, or in the case of a false or fraudulent return, or in the case of a deficiency due to fraud with intent to evade tax, see section 294.

**Sec. 295. Interest on deficiencies.**

Interest upon the amount determined as a deficiency shall be assessed at the same time as the deficiency, shall be paid upon notice and demand from the collector, and shall be collected as a part of the tax, at the rate of 6 per cent per annum from the date prescribed for the payment of the tax, or 5 per cent from the date prescribed for the payment of the first installment thereof, to the date the deficiency is assessed or the date the tax is paid, whichever is the later.

(b) Fraud. If any part of any deficiency is due to fraud, 5 per cent of the total amount of the deficiency (in addition to such deficiency) shall be assessed, collected, and paid in the same manner as if it were a deficiency, except that the provisions of section 272 (d), relating to the prorating of a deficiency, and of section 292, relating to interest on deficiencies, shall not be applicable.

In any case in which the tax has been assessed within the statutory period of limitation properly applicable thereto, a proceeding in court or distraint for the collection of such tax may be begun within six years from the date of the failure thereof, or prior to the expiration of any period for collection agreed upon in writing by the Commissioner and the taxpayer before the expiration of such period agreed upon, or may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon. In determining the running of the statute of limitations in respect of distraint, the distraint shall be held to have been begun, in the case of personal property, on the date on which the levy upon such property is made, or, in the case of real property, on the date on which notice of the time and place of sale is given to the person whose estate it is proposed to sell.

If a notice of deficiency has been mailed to the taxpayer under the provisions of section 272 (a) (see § 29.272-1), then the running of the statute of limitations on the beginning of distraint after assessment, or on the beginning of a proceeding in court without assessment, in respect of any deficiency, shall be suspended for the period during which the Commissioner is prohibited from beginning such distraint or proceeding in court (and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Tax Court of the United States, until the decision of the Tax Court (or the Board becomes final), and for 60 days thereafter.

With respect to the period of limitation upon the collection of the tax on unpaid claims in bankruptcy or receiver proceedings, see section 274 (b) and § 29.274-2.
(a) Tax shown on return—(1) General rule. Where the amount determined by the taxpayer as the tax imposed by this chapter, or any part thereof, or any part of such amount, is not paid on or before the date prescribed for its payment, there shall be added to such amount, as a part of the tax, interest upon such unpaid amount, at the rate of 6 per centum per annum from the date prescribed for its payment until it is paid.

(2) If extension granted. Where an extension of time for payment of the amount so determined, or any part thereof, has been granted by the authority under section 56 (c), there shall be added to such amount, interest at the rate of 6 per centum per annum from the date when such payment should have been made if no extension had been granted, on the unpaid amount for the period of the extension.

Sec. 295. Time extended for payment of tax shown on return.
If the time for payment of the amount determined as the tax by the taxpayer, or any installment thereof, under section 56 (c), shall be extended, and the interest thereon determined under section 292, the provisions of this section shall apply with respect to such extended period.

Sec. 296. Time extended for payment of deficiency.
If the time for payment of any part of a deficiency is extended, there shall be added to such amount, interest at the rate of 6 per centum per annum for the period of such extension, and no other interest shall be collected on such part of the deficiency.

Sec. 297. Interest in case of jeopardy assessment.
(a) In case of the amount collected under section 274 (i) there shall be collected as part of the tax, interest on the part of the deficiency at the rate of 6 per centum per annum for the period from the date on which the judgment became final until such deficiency is paid.

(b) In the case of the failure to make a declaration of estimated tax within the time prescribed, there shall be added to the tax 22 1/2 per centum of such tax, which ever is the greater, for the time with respect to which such failure occurs. 

Sec. 298. Removal of property or departure from United States.
For additions to tax in case of leaving the United States or concealing property in such manner as to prevent its collection, the tax, see section 146.

Sec. 311. Transferred assets.
(a) Method of collection. The amounts of the following liabilities shall, except as hereinafter provided, be collected as part of the tax, in the manner and subject to the same provisions and limitations as in the case of the tax imposed by this chapter as aforesaid.

(1) Transferred liability. The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax (including interest, additional amounts, surtaxes, and additions to the tax provided by law) imposed upon the taxpayer by this chapter.

(b) Transferred assets. The liability of a fiduciary under section 8467 of the Revised Statutes, as amended, in respect of any such liability of a transferee or fiduciary shall be assessed and collected in the same manner and subject to the same provisions and limitations as in the case of the tax imposed by this chapter (including the provisions in case of deficiency in payment after notice and demand, the provisions authorizing distraint and sale for collection, and the provisions prohibiting claims and suits for refunds).

(1) Transferred liability. The liability, at law or in equity, of a transferee of property of a
in the case of a corporation, has terminated its existence.

§ 29.311-1. Claims in cases of transferred assets. The amount for which a transferee of the property of a taxpayer is liable, at law or in equity, and the amount of interest attaching because of the liability may be assessed against the preceding taxpayer or determined as a deficiency in the tax, shall be assessed against such transferee or such fiduciary, as the case may be, and collected and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by chapter 1, except as hereinafter provided. The provisions relating to delinquency in payment after notice and demand and the amount of interest attaching because of such delinquency, the authorization of distraint and proceedings in court for collection, the prohibition of claims for abatement and claims and suits for recovery, the filing of a petition with The Tax Court of the United States, and the filing of a petition for review of The Tax Court's decision, are included in the sections of Chapters 1 and 276 of the Internal Revenue Code (and regulations pertaining thereto) relating to deficiencies in the tax imposed by chapter 1.

The term "transferee" as used in this section includes an heir, legatee, devisee, distributee of an estate of a deceased person, the shareholder of a dissolved corporation, the assignee or donee of an insolvent person, the successor of a corporation, a party to a reorganization as defined in section 112, and all other classes of distributees.

The period of limitation for assessment of the liability of a transferee or of a fiduciary for a transferee or a transferee of the property of the taxpayer, one year after the expiration of the period of limitations for assessment against the taxpayer (see sections 275 to 277, inclusive);

In the case of the liability of a transferor of property of the taxpayer, one year after the expiration of the period of limitation for assessment against the transferor which ever of the two periods (the 1-year period or the 3-year period) first expires;

If a court proceeding against the taxpayer is pending on the date of receipt of the tax or liability in respect thereof, respectively, has been begun within the period of limitation for the bringing of such proceeding, then within one year after the return of execution in such proceeding; and

In the case of the liability of a fiduciary, not later than one year after the liability arises or not later than the expiration of the period of limitation for collection of the tax in respect of which such liability arises, whichever is the later.

(e) If before the expiration of the time prescribed in section 311 (b) (1), (2), or (3) for the assessment of the liability of a transferee or fiduciary, both the Commissioner and the transferee or fiduciary have consented in writing to the assessment of the liability after such time, the liability may be assessed at any time prior to the expiration of the period during which the tax may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

For the purpose of determining the period of limitations for assessment against a transferee or a fiduciary, if the taxpayer is deceased, or, in the case of a corporation, has terminated its existence, the period of limitations for assessment against the taxpayer shall be the period that would be in effect had the death or termination of existence not occurred.

If a notice of the liability of a transferee or of a fiduciary has been mailed to such transferee or to such fiduciary under the provisions of section 272 (a), then the running of the statute of limitations shall be suspended until certified by The Tax Court that the Commissioner is prohibited from mailing the notice of assessment in respect of the liability of the transferee or fiduciary (and in any event, if a proceeding in respect of the notice is pending in The Tax Court, until the decision of The Tax Court becomes final), and for 60 days thereafter.

SECOND. NOTICE OF FIDUCIARY RELATIONSHIP.

(a) If the notice to the Commissioner that any person is acting in a fiduciary capacity such notice shall assume the powers, rights, duties, and privileges of the fiduciary, that the Commissioner is prohibited from mailing the notice of assessment in respect of the liability of the fiduciary (and in any event if a proceeding in respect of the notice is pending in The Tax Court, until the decision of The Tax Court becomes final), and for 60 days thereafter.

(b) Fiduciary of transferee. Upon notice to the Commissioner that any person is acting in a fiduciary capacity such notice shall assume the powers, rights, duties, and privileges of the fiduciary under the provisions of section 272 (a), then the running of the statute of limitations shall be suspended until certified by The Tax Court that the Commissioner is prohibited from mailing the notice of assessment in respect of the liability of the fiduciary (and in any event, if a proceeding in respect of the notice is pending in The Tax Court, until the decision of The Tax Court becomes final), and for 60 days thereafter.

(c) Notice of termination of fiduciary capacity. Notice of termination of the fiduciary capacity under the provisions of section 272 (a), then the running of the statute of limitations shall be suspended until certified by The Tax Court that the Commissioner is prohibited from mailing the notice of assessment in respect of the liability of the fiduciary (and in any event, if a proceeding in respect of the notice is pending in The Tax Court, until the decision of The Tax Court becomes final), and for 60 days thereafter.

(d) Fiduciaries. As soon as the commissioner receives notice that any person is acting in a fiduciary capacity, such notice shall assume the powers, rights, duties, and privileges of the fiduciary, that the Commissioner is prohibited from mailing the notice of assessment in respect of the liability of the fiduciary (and in any event, if a proceeding in respect of the notice is pending in The Tax Court, until the decision of The Tax Court becomes final), and for 60 days thereafter.

(e) Notice of termination of fiduciary capacity. Notice of termination of the fiduciary capacity under the provisions of section 272 (a), then the running of the statute of limitations shall be suspended until certified by The Tax Court that the Commissioner is prohibited from mailing the notice of assessment in respect of the liability of the fiduciary (and in any event, if a proceeding in respect of the notice is pending in The Tax Court, until the decision of The Tax Court becomes final), and for 60 days thereafter.

(f) Fiduciaries. As soon as the commissioner receives notice that any person is acting in a fiduciary capacity, such notice shall assume the powers, rights, duties, and privileges of the fiduciary, that the Commissioner is prohibited from mailing the notice of assessment in respect of the liability of the fiduciary (and in any event, if a proceeding in respect of the notice is pending in The Tax Court, until the decision of The Tax Court becomes final), and for 60 days thereafter.

(g) Fiduciaries. As soon as the commissioner receives notice that any person is acting in a fiduciary capacity, such notice shall assume the powers, rights, duties, and privileges of the fiduciary, that the Commissioner is prohibited from mailing the notice of assessment in respect of the liability of the fiduciary (and in any event, if a proceeding in respect of the notice is pending in The Tax Court, until the decision of The Tax Court becomes final), and for 60 days thereafter.

(h) Fiduciaries. As soon as the commissioner receives notice that any person is acting in a fiduciary capacity, such notice shall assume the powers, rights, duties, and privileges of the fiduciary, that the Commissioner is prohibited from mailing the notice of assessment in respect of the liability of the fiduciary (and in any event, if a proceeding in respect of the notice is pending in The Tax Court, until the decision of The Tax Court becomes final), and for 60 days thereafter.

(i) Fiduciaries. As soon as the commissioner receives notice that any person is acting in a fiduciary capacity, such notice shall assume the powers, rights, duties, and privileges of the fiduciary, that the Commissioner is prohibited from mailing the notice of assessment in respect of the liability of the fiduciary (and in any event, if a proceeding in respect of the notice is pending in The Tax Court, until the decision of The Tax Court becomes final), and for 60 days thereafter.

(j) Fiduciaries. As soon as the commissioner receives notice that any person is acting in a fiduciary capacity, such notice shall assume the powers, rights, duties, and privileges of the fiduciary, that the Commissioner is prohibited from mailing the notice of assessment in respect of the liability of the fiduciary (and in any event, if a proceeding in respect of the notice is pending in The Tax Court, until the decision of The Tax Court becomes final), and for 60 days thereafter.
acting in any fiduciary capacity for any person.

This section, relating to the provisions of section 312, shall not be taken to abridge in any way the powers and duties of fiduciaries provided for in other sections of the Internal Revenue Code.

Sec. 312. Authorization

For prohibition of suits to restrain, enforcement of liability of transferee or fiduciary, see section 3653 (b).

OVERPAYMENTS

Sec. 322. Overpayment of Installments

If the taxpayer pays an installment of the tax more than the amount determined to be the correct amount of such installment, the overpayment shall be credited against the unpaid installments, if any. If the amount already paid, whether or not on the basis of installments, exceeds the amount determined to be the correct amount of the tax, the overpayment shall be credited or refund as provided in section 322.

Sec. 324. Limitation on amount

(a) Authorization—(1) Overpayment.

Where there has been an overpayment of any tax imposed by this chapter, the amount of such overpayment credited against any income, war-profits, or excess-profits tax, or installment thereof due from the taxpayer, and such amount shall be refunded immediately to the taxpayer.

(2) Excessive withholding. Where the amount of the tax withheld at the source under Part II of Subchapter D or Subchapter D of Chapter 9 exceeds the taxes imposed by this chapter against which the tax was withheld, the excess shall be considered an overpayment.

(b) Credit for overpaid tax.

The Commissioner is authorized to prescribe, with the approval of the Secretary, regulations providing for the crediting against the estimated tax for any tax year the amount determined by the taxpayer or the Commissioner to be an overpayment of the tax for a preceding taxable year.

(c) Limitation on allowance—(1) Period of limitation. Unless a claim for credit or refund is filed within three years from the time the overpayment was filed by the taxpayer or within two years from the time the tax was paid, no credit or refund shall be allowed on or made after two years from the time the tax was paid, unless before the expiration of such period a claim therefor is filed by the taxpayer.

(2) Limit on amount of credit or refund. The amount of the credit or refund, shall not exceed the portion of the tax paid as an installment or refund attributable to the deductibility of the tax paid during the three years immediately preceding the filing of the claim.

(a) If a return was filed by the taxpayer, and the claim was filed within three years from the time the return was filed by the taxpayer, during the two years immediately preceding the filing of the claim.

(b) If a claim was filed, and (1) no return was filed, or (2) if the claim was not filed within three years from the time the return was filed by the taxpayer, during the years immediately preceding the filing of the claim.

(c) If no claim was filed and the allowance of the credit or refund is not made within three years from the time the return was filed by the taxpayer, during the two years immediately preceding the filing of the claim.

(d) If no claim was filed, and (1) no return was filed or (2) the allowance of the credit or refund is not made within three years from the time the return was filed by the taxpayer, during the two years immediately preceding the allowance of the credit or refund.

(e) Premature presumption as to date of payment. For the purposes of this section, any the
§ 29.322-1 Authority for abatement, credit, and refund of tax. Authority for the credit and refund of any overpayment of tax imposed by chapter 1 is contained in section 322. Section 273 (f) prohibits the filing of claims for abatement by taxpayers with respect to assessments of income tax imposed by chapter 1.

§ 29.322-2 Credit and refund adjustments. Overassessments and overpayments of income taxes will be adjusted by means of certificates of overassessment. Credits or refunds of overpayments in the basis of such certificates of overassessment may not be allowed or made, however, after the expiration of the statutory period of limitation properly applicable unless prior to the expiration of such period a claim therefor on Form 843 has been filed by the taxpayer. The claim, together with appropriate supporting evidence, must be filed in the office of the collector for the district where the tax was paid. If an amount of tax in excess of that properly due has been paid by a withholding agent, the credit or refund for such excess amount shall be made to the withholding agent, unless the amount of tax was actually withheld by the withholding agent. (See section 143 (f).)

As to interest in case of credits or refunds, see section 3771, and section 177, United States Judicial Code, as amended by section 615 of the Revenue Act of 1926 and section 808 of the Revenue Act of 1938.

§ 29.322-3 Claims for refund by taxpayers. Claims by the taxpayer for the refunding of taxes, interest, penalties, and additions to tax erroneously or illegally collected shall be made on Form 843, and should be filed with the collector of internal revenue. A separate claim in such form shall be made for each taxable year or period.

The claim must set forth in detail and under oath each ground upon which a refund is claimed, and facts sufficient to apprise the commissioner of the basis thereof. No refund or credit will be allowed after the expiration of the statutory period of limitation applicable to the filing of a claim therefor except upon one or more of the grounds set forth in a claim filed prior to the expiration of such period. A claim which does not comply with this paragraph will not be considered for any purpose as a claim for refund. That a claim for refund has been paid out earlier than the fifteenth day of the month following the close of the taxable year with respect to which such refund was allowed is contained in section 322.

(1) Tax withheld at source. For refund or credit in case of withholding agent, see section 1622 (f).

Authority for abatement, credit, and refund of tax is allowable as provided by section 143 (d), effective July 1, 1943. Prior to such amendment section 322 (f) read as follows: "For refund or credit in case of withholding agent, see sections 149 (f) and 466 (f)."

§ 29.322-4 Claim for payment of judgment obtained against collector. (a) A claim for the amount of a judgment against a collector of internal revenue for the recovery of taxes, penalties, or other sums should be made under oath, on Form 843, and filed directly with the Commissioner of Internal Revenue, Washington, D. C. Two certified copies of the final judgment and a certificate of probable cause should be attached to the claim. If the payment of court costs is claimed, an itemized bill of the court costs paid, receipted by both parties to the suit, should be attached to the claim. If the judgment debtor shall have already paid the amount recovered against him, the claim should be made in his name, accompanied by two certified copies of the final judgment, and an itemized bill of the court costs paid, receipted by both parties to the suit, 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, should accompany the claim. (See further § 29.322-3.)

(b) If the judgment debtor shall have obtained his judgment by recovery of any money exacted from him, or for the recovery of any money exacted from him by the collector or other officer of the Government, no execution shall issue against such collector or other officer, unless it shall be shown upon final judgment, that the judgment was recovered or other satisfactory evidence, showing that the judgment has been satisfied and specifying the exact sum paid in its satisfaction, should accompany the claim. (See further § 29.322-3.)
§ 29.322-7 Limitations upon the crediting and refunding of taxes paid—

(a) General rule. Unless a claim for credit or refund of an overpayment is filed within three years from the time the return was filed by the taxpayer or within two years from the time the tax was paid, the Commissioner is prohibited from allowing or making a credit or refund of income tax imposed by chapter 1 for such tax paid during periods which have expired. If no return is filed by the taxpayer, the Commissioner is prohibited from allowing or making a credit or refund of such tax after two years from the time the tax was paid unless within six months after the expiration of such 2-year period a claim therefor is filed. The amount of the credit or refund in such case shall not, however, exceed the sum of:

(1) The portion of the tax paid during the two years immediately preceding the execution of the agreement between the Commissioner and the taxpayer, or, if such agreement was executed within three years from the time the return was filed, during the three years immediately preceding the execution of such agreement;

(2) The portion of the tax paid after the execution of the agreement between the Commissioner and the taxpayer or before the expiration of the period within which the Commissioner might make an assessment pursuant to such agreement or any extension thereof; and

(3) The portion of tax paid during the six months immediately following the expiration of the period within which the Commissioner might make an assessment pursuant to such agreement or any extension thereof, if credit or refund is allowed or made. If any portion of the tax is paid within six months after the expiration of the period within which the Commissioner might make an assessment pursuant to an agreement between the taxpayer and the Commissioner or any extension thereof, and if credit or refund is allowed or made after such payment and before the end of such 6-month period, or if claim for credit or refund is filed after such payment and before the end of such 6-month period, then the limitations on such credit or refund set forth in the preceding provisions of this subsection.

Credit or refund may be allowed or made within six months after the expiration of the period within which the Commissioner might make an assessment pursuant to an agreement between the Commissioner and the taxpayer or any extension thereof, and if credit or refund is allowed or made after such payment and before the end of such 6-month period, or if claim for credit or refund is filed after such payment and before the end of such 6-month period, then the limitations on such credit or refund set forth in the preceding provisions of this subsection.

(b) Limitations in case waiver executed. If the Commissioner and the taxpayer, within three years from the time the return was filed by the taxpayer or within two years from the time the tax was paid, whichever period expires the later, have agreed in writing under the provisions of section 276 (b) to extend beyond the period prescribed in section 276 the time within which the Commissioner may make an assessment, then the period within which a claim for credit or refund may be filed, or a credit or refund may be allowed or made if no claim is filed, is the period within which the Commissioner may make an assessment pursuant to such agreement or any extension thereof, and if credit or refund is allowed or made after such payment and before the end of such 6-month period, or if claim for credit or refund is filed after such payment and before the end of such 6-month period, or if credit or refund is allowed or made after such payment and before the end of such 6-month period, or if claim for credit or refund is filed after such payment and before the end of such 6-month period, or if claim for credit or refund is filed after such payment and before the end of such 6-month period. If any portion of the tax is paid within six months after the expiration of the period within which the Commissioner might make an assessment pursuant to an agreement between the Commissioner and the taxpayer or any extension thereof, and if credit or refund is allowed or made after such payment and before the end of such 6-month period, or if claim for credit or refund is filed after such payment and before the end of such 6-month period, then the limitations on such credit or refund set forth in the preceding provisions of this subsection.

Credit or refund may be allowed or made within six months after the expiration of the period within which the Commissioner might make an assessment pursuant to an agreement between the Commissioner and the taxpayer or any extension thereof, and if credit or refund is allowed or made after such payment and before the end of such 6-month period, or if claim for credit or refund is filed after such payment and before the end of such 6-month period, or if claim for credit or refund is filed after such payment and before the end of such 6-month period, or if claim for credit or refund is filed after such payment and before the end of such 6-month period, or if claim for credit or refund is filed after such payment and before the end of such 6-month period, or if claim for credit or refund is filed after such payment and before the end of such 6-month period. If any portion of the tax is paid within six months after the expiration of the period within which the Commissioner might make an assessment pursuant to an agreement between the Commissioner and the taxpayer or any extension thereof, and if credit or refund is allowed or made after such payment and before the end of such 6-month period, or if claim for credit or refund is filed after such payment and before the end of such 6-month period, or if claim for credit or refund is filed after such payment and before the end of such 6-month period, or if claim for credit or refund is filed after such payment and before the end of such 6-month period, or if claim for credit or refund is filed after such payment and before the end of such 6-month period.
The provisions of this paragraph with regard to an overpayment caused by the deductibility of a bad debt under section 23 (c) (1), section 23 (k) (4), or section 204 (c) or of a loss from the wrongfulness of a security under section 23 (g) (2) or (k) (2) are likewise applicable in cases where a liability which has on the application to the taxpayer of a carry-over or a carry-back.

For the purposes of this chapter the term "foreign personal holding company" means any foreign corporation if—

(a) General rule. For the purposes of this chapter the term "foreign personal holding company" means any foreign corporation if—

(1) Gross income requirement. At least 50 per centum of its gross income (as defined in section 231 (a)) for the taxable year has been derived from personal holding company income as defined in section 332; but if the corporation is a foreign personal holding company with respect to any taxable year ending after August 23, 1937, then, for each subsequent taxable year, the minimum percentage shall be 50 per centum in lieu of 59 per centum, until a taxable year during the whole of which the stock ownership required by paragraph (2) does not exist, or until the expiration of ten consecutive taxable years in each of which less than 59 per centum of the gross income was derived from personal holding company income.

(b) Both requirements must be satisfied and both must be met with respect to each taxable year.

A foreign corporation which comes within the classification of a foreign personal holding company does not include a corporation exempt from taxation under section 101.

§ 29.331-1 Definition of foreign personal holding company. A foreign personal holding company is any foreign corporation (other than a corporation exempt from taxation under section 101) which for the taxable year meets (a) the gross income requirement specified in § 29.331-2, and (b) the stock ownership requirement specified in § 29.331-3.

§ 29.331-2 Gross income requirement. To meet the gross income requirement, it is necessary that either of the following percentages of gross income of the corporation for the taxable year (including the one taxable year immediately preceding the tax year) is includible therein as a dividend by reason of the application of section 315 (c) (2) and (c) (3) and section 3950,

(a) 60 percent or more; or

(b) 50 percent or more if the foreign corporation has been classified as a foreign personal holding company for any taxable year ending after August 23, 1937, unless—

(1) A taxable year has intervened since the last taxable year for which it was so classified, during no part of which...
the stock ownership requirement specified in section 331 (a) (2) exists; or

(2) Three consecutive years have intervened since the last taxable year for which it was so classified, during which its foreign personal holding company income was less than 50 percent of its gross income.

In determining whether the foreign personal holding company income is equal to the required percentage of the total gross income, the determination must not be made upon the basis of gross receipts, since gross income is not synonymous with such receipts. For a further discussion of what constitutes "gross income," see section 22 (a) and §§ 29.22 (a)-1 to 29.22 (a)-20, inclusive.

§ 29.331-3 Stock ownership requirement. To meet the stock ownership requirement, it is necessary that at some time in the taxable year more than 50 percent in value of the outstanding stock of the foreign corporation be owned, directly or indirectly, by or for no more than five individuals citizens or residents of the United States, hereinafter referred to as "United States group." For such purpose, the ownership of the stock must be determined as provided in section 293 and §§ 29.333 (a)-1 to 29.333 (a)-7, inclusive, and § 29.333 (b)-1.

In the event of any change in the stock outstanding during the taxable year, whether in the number of shares or classes of stock, or whether in the ownership thereof, the conditions existing immediately prior to and subsequent to each change must be taken into consideration, since a corporation comes within the classification if the statutory conditions with respect to stock ownership are present at any time during the taxable year.

In determining whether the statutory conditions with respect to stock ownership are present at any time during the taxable year, the phrase "in value," shall, in the light of all the circumstances, be deemed to mean the par value, or dividend paying capacity, appreciation of assets, together with such other factors as have a bearing upon the value of the stock. If the value of the stock which is used is greatly at variance with that reflected by the corporate books, the evidence of such value should be filed with the return.

For any case where there are two or more classes of stock outstanding, the total value thereof shall be allocated among the different classes according to the relative value of each class therein.

Sec. 332. Foreign personal holding company income.
For the purposes of this chapter the term "foreign personal holding company income" means the portion of the gross income determined for the purposes of section 331 (a) (1), which consists of:

(a) Dividends. Interest, royalties, annuities.

(b) Stock and securities transactions. Except in the case of regular dealers in stock or securities, gains from the sale or exchange of stock or securities.

(e) Commodity transactions. Gains from futures transactions in any commodity on or subject to the rules of a board of trade or commodity exchange. This subsection shall not apply to gains by a producer, processor, merchant, or handler of the commodity, which arises out of bona fide hedging transactions reasonably necessary to the conduct of its business in the manner in which such business is customarily and usually conducted by others. The term "annuities" includes annuities only to the extent includible in the computation of gross income. (See section 22 (b) (2).)

(f) Gain from the exchange of stock or securities. The term "gains from the sale or exchange of stock or securities" as used in section 332 (b) applies to all gains (including gains from liquidating dividends and distributable profits from capital) from the sale or exchange of stock or securities includible in gross income. The term "stock or securities" as used in section 332 (b) means stocks, bonds, debentures, certificates of indebtedness, notes, car trust certificates, bills of exchange, and obligations issued by or on behalf of the United States, its agencies and instrumentalities; State, Territory, or political subdivision thereof. In the case of "regular dealers in stock or securities" the term does not include gains derived from the sale or exchange of stock or securities not includible in gross income.

The term "regular dealers in stock or securities" as used in section 332 (b) means corporations with an established place of business regularly engaged in the purchase of stock or securities and their resale to customers, but such corporations are not dealers with respect to stock or securities held for speculation or investment.

(g) Rents. Rents, unless constituting 50 percent or more of the gross income. For the purposes of this chapter the term "rents" means compensation, however designated, for the use of or for right to use, property of the corporation in any case where, at any time during the taxable year, 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by a United States group. If the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform, such services.

(h) Commodity transactions. Gains from futures transactions in any commodity on or subject to the rules of a board of trade or commodity exchange, but do not include gains from cash transactions or gains by a producer, processor, merchant, or handler of the commodity, which arises out of bona fide hedging transactions reasonably necessary to the conduct of its business in the manner in which such business is customarily and usually conducted by others. In general, foreign personal holding company income includes gains on futures contracts which are speculative in character, or representing true hedges against price fluctuations. Futures transactions in spot goods are not speculative transactions, though not concurrent with spot transactions. Futures contracts which are not hedges against spot transactions are speculative unless they are hedges against concurrent futures or forward sales or purchases.

(i) Income from estates and trusts. Income from estates and trusts which includes the income from estates and trusts which is to be included in foreign personal holding company income consists of the income from estates and trusts which is required to be included in the

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gross income of the corporation under sections 161 to 169, inclusive, together with the gains derived by the corporation from the sale or other disposition of any interest in an estate or trust.

(b) Amounts received under personal service contracts. Amounts includible in foreign personal holding company income as amounts received under personal service contracts consist of amounts received pursuant to a contract under which the corporation is to furnish personal services and amounts received from a sale or other disposition of such a contract, if:

1. Some person other than the corporation, designated (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or description in the contract) and
2. At some time during the taxable year 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual designated to perform such services, or the individual is designated (by name or by description), as the one to perform such services. For this purpose the stock ownership must be determined as provided in section 332 and subsections (a)–1 to 332 (a)–7, inclusive, and § 29.333 (b)–1.

The application of section 332 (e) may be illustrated by the following example:

Example. The Corporation, a foreign corporation, the entire outstanding capital stock of which is owned, directly or indirectly, by four individuals, is a personal service company. The Corporation entered into a contract with a holding corporation, a foreign corporation, the entire outstanding capital stock of which is owned, directly or indirectly, by four individuals, to furnish personal services for a period of ten years. The holding corporation received 60,000 shares of the Corporation's stock and the Corporation received 500,000, a year from the holding corporation. The Corporation entered into a contract with the O Corporation in which A was designated to perform personal services for the O Corporation, in consideration of which the O Corporation was to pay the M Corporation $50,000 per year. The Corporation received the M Corporation's stock from the O Corporation, which stock constitutes foreign personal holding company income.

(1) Compensation for use of property. The compensation for the use of, or the right to use, property of the corporation which is to be included in foreign personal holding company income consists of amounts received as compensation (however designated and from whomsoever received) for the use of, or the right to use, property of the corporation in any case, in which at any time during the taxable year 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for an individual entitled to the use of the property, or the right to use, which is owned, directly or indirectly, by or for such individual, and no one but the individual is entitled to the use of, or the right to use, the property, whether such right is obtained directly from the corporation or by means of a sublease or other arrangement. The property may consist of a yacht, a city residence, a country house, an automobile, or any other kind of property, but do not include amounts constituting foreign personal holding company income under section 332 (f) and paragraph (f) of this section. Therefore, rents which are to be included in foreign personal holding company income consist of compensation, however designated, including charter fees, etc., for the use of, or the right to use, real property, or any other kind of property, but do not include amounts constituting foreign personal holding company income under section 332 (f) and paragraph (f) of this section. However, rents do not constitute foreign personal holding company income if constituting 50 percent or more of the gross income of the corporation.

§ 29.333 Stock ownership. (a) Constructive ownership. For the purpose of determining whether a foreign corporation is a foreign personal holding company, a stock ownership requirement provided in section 332 (a)–1 to 332 (a)–7, inclusive, and § 29.333 (b)–1.

(1) Stock not owned by individual. Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust, shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries.

(2) Family and partnership ownership. An individual is considered as owning the stock, directly or indirectly, or for his family or by or for his partner. For the purposes of this section a family of an individual includes only his children and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

(3) Options. If any person has an option to acquire stock such stock shall be considered as being owned proportionately by the option owner, his family, and partners.

(b) Compensation for the use of property.

(1) Option rule in lieu of family and partnership ownership. If stock may be considered as owned by an individual under either paragraph (a) (1) or (2), it shall be considered as owned by him under paragraph (a) (2).
By applying the statutory rule provided in section 29.333 (a) (2) five individuals own more than 50 percent of the outstanding stock as follows:

<table>
<thead>
<tr>
<th>Individual</th>
<th>Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>100</td>
</tr>
<tr>
<td>B</td>
<td>100</td>
</tr>
<tr>
<td>C</td>
<td>20</td>
</tr>
<tr>
<td>D</td>
<td>10</td>
</tr>
<tr>
<td>E</td>
<td>30</td>
</tr>
</tbody>
</table>

The family and partnership rule and the option rule must be applied independently for each of the purposes stated in § 29.333 (a) (1).

§ 29.333 (a) 4 Options. In determining the ownership of stock for any of the purposes set forth in § 29.333 (a) (1), stock constructively owned by a person for the purpose of applying either the rule provided in section 29.333 (a) (1) relating to stock not owned by an individual (see § 29.333 (a) (2) shall be considered as actually owned by such person for the purpose of applying the family and partnership rule provided in section 29.333 (a) (2) in order to make another person the constructive owner of stock of the S Corporation owned by B.

(b) Stock constructively owned by an individual for the purpose of applying either the rule provided in section 29.333 (a) (1), relating to stock not owned by an individual, or the family and partnership rule provided in section 29.333 (a) (2) in order to make another person the constructive owner of stock of the S Corporation owned by B.

The application of this section may be illustrated by the following examples:

Example (1). A is a United States citizen, whose wife, AW, owns all of the stock of the M Corporation, which in turn owns all the stock of the O Corporation. The M Corporation owns all the stock of the P Corporation.

Under the rule provided in section 29.333 (a) (1), relating to stock not owned by an individual, the stock in the P Corporation owned by the O Corporation is considered to be owned constructively by the shareholder of the O Corporation. Such constructive ownership of the stock in the M Corporation is considered as actual ownership for the purposes set forth in § 29.333 (a) (1), in order to make A the constructive owner of the stock of the P Corporation. Similarly, the constructive ownership of the stock by AW is considered as actual ownership for the purpose of applying the family and partnership rule provided in section 29.333 (a) (2) in order to make A the constructive owner of the stock of the P Corporation.
stock is subject to the exception that, if some of the outstanding securities are convertible only after a later date than in the case of others, the class having the earlier conversion date may be considered as outstanding stock although the others are not so considered, but the conversion of those convertible in 1942 through 1944 may be considered as outstanding stock unless all outstanding securities having a prior conversion date are also so considered. Furthermore, if outstanding securities on which the effect of the inclusion of stock without so considering those convertible in 1942 and the securities convertible in 1944 could not be properly considered as outstanding stock without so considering those convertible in 1944. However, the securities convertible in 1943 could not be properly considered as outstanding stock without so considering those convertible in 1942 and 1943 can be properly considered as outstanding stock without so considering those convertible in 1942.

The requirements in paragraphs (1), (2), and (3) that all convertible securities must be included if any are to be included shall be subject to the exception that, where some of the options are convertible only after a later date than in the case of others, the class having the earlier conversion date may be considered as outstanding stock for the purpose of the stock ownership requirements of section 331 (a) (2), but only if the effect of such consideration is to make the corporate foreign personal holding company. Such convertible securities shall be considered as outstanding stock for the purpose of section 332 (e), relating to amounts received under personal service contracts, or of section 332 (f), relating to compensation for the use of property, but only if the effect of such consideration is to make the corporate foreign personal holding company income. The consideration of convertible securities as outstanding stock therefore, relating to the taxation of foreign corporations generally. Hence, for such purposes, the gross income includes income from all sources, without regard to the provisions of Supplement P net income of the second company for its taxable year as the portion of such taxable year up to and including such last day bears to the entire taxable year.

The rules provided in subsection (b) shall be applied in the case of every foreign corporation with respect to which a United States group exists, in whole or in part, in the gross income of its shareholders, whether United States shareholders or other foreign personal holding companies, there shall be included as a dividend in the gross income of the first company for the taxable year in which or with which the taxable year of the second company ends, the amount which bears the same ratio to the undistributed Supplement P net income of the second company as the amount of such taxable year up to and including such last day bears to the entire taxable year.

The application of this section may be illustrated by the following examples:

(a) A foreign corporation meets the gross income requirements of section 331 (a) (2), and the regulations pertaining thereto, relating to the taxation of foreign corporations generally. Hence, for such purposes, the gross income includes income from all sources, without regard to the provisions of Supplement P net income of the second company for its taxable year as the portion of such taxable year up to and including such last day bears to the entire taxable year. The foregoing rules apply to the chain of foreign corporations regardless of the number of corporations included in the chain.

The application of this section may be illustrated by the following examples:

(a) A foreign corporation meets the stock ownership requirement specified in § 29.331-2, regardless of whether or not a United States group exists, and

(b) Such foreign corporation is a shareholder in a foreign personal holding company on any day of a taxable year of the second company which ends with or within the taxable year of the first company and such day is the last day in the taxable year of the second company.

§ 29.334-2 Additions to gross income for purposes of Supplement P. If, for any taxable year:

(a) A foreign corporation meets the gross income requirements of section 331 (a) (2), and the regulations pertaining thereto, relating to the taxation of foreign corporations generally. Hence, for such purposes, the gross income includes income from all sources, without regard to the provisions of Supplement P net income of the second company for its taxable year as the portion of such taxable year up to and including such last day bears to the entire taxable year. The foregoing rules apply to the chain of foreign corporations regardless of the number of corporations included in the chain.

The application of this section may be illustrated by the following examples:

(a) A foreign corporation meets the stock ownership requirement specified in § 29.331-2, and

(b) Such foreign corporation is a shareholder in a foreign personal holding company on any day of a taxable year of the second company which ends with or within the taxable year of the first company and such day is the last day in the taxable year of the second company.

§ 29.334-3 Gross income of foreign personal holding companies. (a) General rule. As used in this Supplement P for the purposes of the term "gross income" means gross income computed (without regard to the provisions of Supplement P) as if the foreign corporation were a domestic corporation.

(b) Additions to gross income. In the case of a foreign personal holding company or of a domestic corporation, any amounts which bears the same ratio to the undistributed Supplement P net income of the second company as the amount of such taxable year up to and including such last day bears to the entire taxable year.

§ 29.334-1 Gross income in general for purposes of Supplement P. For all purposes of Supplement P (sections 331 to 346, inclusive) and the regulations pertaining thereto, the gross income of a foreign corporation shall be computed as if the corporation were a domestic corporation.
Example (1). The X Corporation is a foreign personal holding company whose stock is owned by A, a United States citizen. The X Corporation owns the entire stock of the Y Corporation and another foreign personal holding company, the Z Corporation. The calendar year of the X Corporation is the fiscal year ending June 30, 1943, more than the required percentage of the stock of the X Corporation is owned by United States citizens. For the fiscal year ending June 30, 1943, the undistributed Supplement P net income of the X Corporation was $100,000. Upon the basis of these facts the X Corporation is a foreign personal holding company for the fiscal year ending June 30, 1943, because it is a 90% owner of a foreign personal holding company, the Z Corporation, and the undistributed Supplement P net income of the X Corporation is included in the gross income of the X Corporation for the purpose of determining whether the X Corporation is a foreign personal holding company. If, after the inclusion of such net income, the X Corporation is not a foreign personal holding company, the undistributed Supplement P net income of the X Corporation would be included in the gross income of the X Corporation for the purpose of determining whether the X Corporation is a foreign personal holding company. If, after the inclusion of such net income, the X Corporation is a foreign personal holding company, the undistributed Supplement P net income of the X Corporation would be included in the gross income of the X Corporation.

(a) The corporation was a shareholder in the Y Corporation on September 30, 1943, or on a day in the taxable year of the Y Corporation and the United States group existed with respect to the Y Corporation for the purpose of determining whether the Y Corporation is a foreign personal holding company. Under the undistributed Supplement P net income of the Y Corporation which is includible in the gross income of the Y Corporation and in determining its undistributed Supplement P net income. If all three corporations are foreign personal holding companies, the undistributed Supplement P net income of each would, in this manner, be reflected as a dividend in the hands of the ultimate beneficial shareholder of the chain.

In the event that after the inclusion of the undistributed Supplement P net income of the X Corporation, the Y Corporation is not a foreign personal holding company, then in that event the Y Corporation or the Y Corporation would be included in the gross income of the X Corporation and, its undistributed Supplement P net income would be determined independently of the income of the Y Corporation and the Z Corporation.

Sec. 335. Undistributed Supplement P net income of A

For the purposes of this chapter the term "undistributed Supplement P net income" is defined in section 335, and the amount of the basic surtax credit provided in section 27 (b) (1), by the amount of the credit provided in section 26 (a) (5), relating to interest on certain obligations of the United States and Government corporations.

Sec. 335. Supplement P net income [as amended by secs. 211 (g), 212 (b), Rev. Act 1936; sec. 135 (d), 150 (b), Rev. Act 1939].

For the purposes of this chapter the term "Supplement P net income" means the net income with the following adjustments:

(a) Additional deductions. There shall be allowed as deductions—

(1) Federal income, war-profits, and ex-cess-profits taxes paid or accrued during the taxable year to the extent not allowed as a deduction under section 23 (q) for the purposes therein specified, to an amount which does not exceed 16 per centum of the amount of the tax paid or accrued during the taxable year.

(2) Federal income, war-profits, and ex-cess-profits taxes paid or accrued during the taxable year to the extent not allowed as a deduction under section 23 (q) for the purposes therein specified, to an amount which does not exceed 16 per centum of the amount of the tax paid or accrued during the taxable year.

(3) Contributions or gifts paid, or contributed, that are includible in the gross income of the amounts which are made within the taxable year, or for the use of donees described in section 23 (q) for the purposes therein specified, to an amount which does not exceed 16 per centum of the amount of the tax paid or accrued during the taxable year.

(4) Federal income, war-profits, and ex-cess-profits taxes paid or accrued during the taxable year to the extent not allowed as a deduction under section 23 (q) for the purposes therein specified, to an amount which does not exceed 16 per centum of the amount of the tax paid or accrued during the taxable year.
§ 29.336-1 Supplement P net income. 

The term "Supplement P net income" means the gross income as defined in section 334 less the deductions provided in section 23 (computed without regard to the provisions of Supplement I (sections 231 to 238, inclusive), subject to the qualifications, limitations, and exceptions provided in section 336). 

In addition to the qualifications, limitations, and exceptions provided in sections 336 (a) and 336 (b) (1), a foreign personal holding company is subject to the provisions of section 336. 

The net income as so computed is not placed on an annual basis under section 47 (c). 

The deduction for net operating losses provided in section 23 (a) shall not be allowed. 

The net income shall be computed without regard to section 117 (e) (3). 

Incurred on or about 24th of each month.

The net income shall be computed without regard to section 47 (c).

§ 29.336-2 Illustration of computation of Supplement P net income and undistributed Supplement P net income. 

Example. The following facts exist with respect to the M Corporation, a foreign personal holding company, for the calendar year 1942:

The gross income of the corporation as defined in section 23 (b), is $150,000, of which $35,000 represents its distributive share of the undistributed net income of a foreign personal holding company in which it is a shareholder, $80,000 consists of dividends, $10,000 consists of interest, and the remainder ($50,000) consists of capital gains and losses on the sale of ordinary and necessary office expenses allowable as a deduction. 

The claim for deduction for the expenses of, and depreciation on, the property owned in excess of the income received, is not established as provided in section 335 (b) (2). 

The office property amounts to $30,000. 

Federal income tax withheld at the source on the income of the corporation from sources within the United States amounts to $65,100. 

No gain from the sale or exchange of stock or securities is realized during the taxable year, but losses in the aggregate amount to $45,000, sustained from the sale of stock or securities which constitute capital assets. 

Examples are not allowed as a deduction in any amount under the provisions of sections 131 and 336 (c).

Contributions paid by the corporation to the United States amounts to $5,000.

The net income for computing the Supplement P net income of the corporation (including the distributive share of the undistributed Supplement P net income of the other foreign personal holding company) is $180,000, which is deductible in computing net income under section 21.

Dividends paid by the corporation to its shareholders during the taxable year amount to $50,000.

The net income for the purposes of computing the Supplement P net income of the corporation is $180,000, computed as follows (assuming for the purposes of this example only that the expenses of, and depreciation on, the rented property are deductible under section 23):

**Income (Section 22)**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (in dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends</td>
<td>$200,000</td>
</tr>
<tr>
<td>Interest</td>
<td>10,000</td>
</tr>
<tr>
<td>Rent</td>
<td>8,000</td>
</tr>
<tr>
<td><strong>Gross income as defined in section 22</strong></td>
<td>215,000</td>
</tr>
<tr>
<td><strong>Add:</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Distributive share of undistributed Supplement P net income of the other foreign personal holding company (considered as a dividend)</strong></td>
<td>85,000</td>
</tr>
<tr>
<td><strong>Deductions (Section 23)</strong></td>
<td></td>
</tr>
<tr>
<td>Expenses allowable to operation of the rented property</td>
<td>$75,000</td>
</tr>
<tr>
<td>Ordinary and necessary expenses (office)</td>
<td>10,000</td>
</tr>
<tr>
<td>Contributions (within the 5 percent limitation specified in section 23 (q))</td>
<td>5,000</td>
</tr>
<tr>
<td><strong>Net income for purposes of computing Supplement P net income</strong></td>
<td>120,000</td>
</tr>
</tbody>
</table>
The Supplement P net income and the undistributed Supplement P net income of the corporation are $210,878 and $190,878, respectively, computed as follows:

Net income for purposes of computing Supplement P net income: $180,000.

Excess property expenses and depreciation over amount of rent received: $5,000.

Deduct (see section 336 (a)): Federal income taxes: $95,123.

Net additions under section 336: $30,878.

Supplement P net income: $210,878.

Undistributed Supplement P net income: $190,878.

Sec. 337. Corporation income tax due to United States shareholders. (As amended by sec. 128 (2), Rev. Act 1941.)

(a) General rule. The undistributed Supplement P net income of a foreign personal holding company shall be included in the gross income of the citizens or residents of the United States, domestic corporation, domestic partnerships, and estates or trusts (other than estates or trusts the gross income of which under this chapter includes only income from sources within the United States) who are shareholders in such foreign personal holding company (hereinafter called “United States shareholders”) in the manner and to the extent set forth in this section.

(b) Amount included in gross income. Each United States shareholder, who was a shareholder on the day in the taxable year of the company which was the last day on which a United States shareholder was a shareholder (as defined in section 331 (a) (2)) which existed with respect to the company, shall include in his gross income, as a dividend, directly or indirectly, the amount properly includible therein under subsection (b) of section 337 (a) of the United States shareholders, accordingly, are determined by the stock holdings as of such specified time. This rule applies to every United States shareholder who was a shareholder in the company at the specified time regardless of whether the United States shareholder is included within the United States group. For example, a domestic corporation which is a United States shareholder at the specified time must return its distributive share of the taxable year of the company. Income even though the domestic corporation cannot be included within the United States group since, under section 333 (1) and 393 (a) (2), the income of the foreign personal holding company is considered as being owned, proportionately, by its shareholders for the purpose of determining whether the foreign corporation is a foreign personal holding company. The United States shareholders must include in their gross income their distributive shares of that portion of the undistributed Supplement P net income of the foreign personal holding company which is equal to the portion of the taxable year up to and including the last day on which the United States shareholder was a shareholder of the company. Thus, if the last day in the taxable year on which the required United States group existed was also the end of the taxable year, the portion of the taxable year up to and including the last day would be equal to 100 percent and in such case, the United States shareholders would be required to return their distributive shares in the entire
undistributed Supplement P net income. Through 1942, the year in which the United States group existed was September 30, and the taxable year was a calendar year, the portion of the taxable year up to and including such last day would be equal to nine-twelfths and in that calendar year the share of A would be required to return their distributive share only in nine-twelths of the undistributed Supplement P net income.

The amount which each United States shareholder in the foreign personal holding company, that is, by the number of shares of stock owned by the United States shareholder and the relatable stock outstanding, if there are several classes of stock outstanding. Thus, if a foreign personal holding company has both common and preferred stock outstanding and the preferred stock is owned by the United States shareholder, his distributive share as income for the calendar year ending November 30, 1942, and if the United States shareholder had no earnings and profits, but distributed $100,000, the amount so distributed would be tax-free in the hands of both A and B. If, however, at the end of the calendar year 1942, other than that stock dividends on which the United States group last received interest, which the United States group last received interest, which he would have received as a dividend on the last day on which the United States shareholder was required to return is that amount required portion of the undistributed Supplement P net income.

For example, the M Corporation is a foreign personal holding company which owns all the stock of the N Corporation, another foreign personal holding company. Both companies receive interest on obligations of the United States or its instrumentalities as specified in section 334 (a) and (2), and thereby receive the United States personal holding company. The information required by the Internal Revenue Code and regulations prescribed as necessary for carrying out the provisions of section 334 (b) and § 29.334-2. For purposes of the tax imposed by sections 11, 13, 14, 201, 204, 207, or 326, a credit against his net income for his proportionate share of whatever interest on obligations of the United States, and not for any part of the interest received by the foreign personal holding company which the United States shareholder in the foreign personal holding company as a dividend, treated as a payment of the specified dividend before any part may be allocated as a dividend on the preferred stock before any part may be allocated as a dividend on the common stock.

The nondistributive share of the required portion of the undistributed Supplement P net income must be returned as dividend income by the United States shareholders for their respective taxable years in which or with which the taxable year of the foreign personal holding company ends. For example, if the M Corporation whose taxable year is the calendar year is a foreign personal holding company and if A, a United States shareholder in the United States group last received interest on obligations of the United States or its instrumentalities as specified in section 334 (a) (1) and (2), may be included in the gross income of the company for such taxable year, with the exception of any such interest which is includible in gross income of the company for such taxable year by the application of the provisions of section 334 (b) and § 29.334-2. For reduction of credit for such interest on account of amortizable bond premium, see § 20.125-5.

§ 29.337-3 Information in return. The information required by section 337 (d) in the returns of certain United States shareholders relates only to the taxable year of a foreign personal holding company for which is computed such corporation's undistributed Supplement P net income, all or part of which must be included in gross income by the United States shareholder in the form of a statement attached to the return.

§ 29.337-4 Effect on capital account of foreign personal holding company and basis of stock in hands of shareholders. Sections 337 (e) and 337 (d) are designed to prevent double taxation with respect to the undistributed Supplement P net income of foreign personal holding companies. The application of such sections may be illustrated by the following examples:

Example (1). The M Corporation is a foreign personal holding company. Twenty-five percent in value of its capital stock is owned by A, a citizen of the United States, and the remainder, or 25 percent, of its stock is owned by B, another United States shareholder. For the calendar year 1942 the M Corporation has an undistributed Supplement P net income of $375,000. After the $75,000 is distributed by the M Corporation tax-free the basis of A's stock, assuming no other changes, would be $300,000 if A failed to include the $75,000 in gross income in his return as required by the Internal Revenue Code and regulations prescribed as necessary for carrying out the provisions of section 334 (b) (1). If the M Corporation failed to include the $75,000 in gross income in his return as required by the Internal Revenue Code and regulations prescribed as necessary for carrying out the provisions of section 334 (b) (1), the amount A would have to include in his gross income, proper adjustment being made to the basis of A's stock, as a result of such adjustment.

§ 29.337-2 Credit for obligations of the United States. Each United States shareholder required to return his distributive share in the undistributed Supplement P net income of a foreign personal holding company for any taxable year is allowed, for purposes of the tax imposed by section 11, 13, 14, 201, 204, 207, or 326, a credit against his net income for his proportionate share of whatever interest on obligations of the United States, and not for any part of the interest received by the foreign personal holding company which the United States shareholder in the foreign personal holding company as a dividend, treated as a payment of the specified dividend before any part may be allocated as a dividend on the preferred stock before any part may be allocated as a dividend on the common stock.

After the $100,000 is paid-in surplus as a contribution to capital, the M Corporation has an undistributed Supplement P net income of $375,000. If A included in gross income in his return for the calendar year 1942 the $75,000 as a constructive dividend from the M Corporation, the basis of his stock would be $375,000. After the $75,000 is distributed by the M Corporation tax-free the basis of A's stock, assuming no other changes, would be $300,000 if A failed to include the $75,000 in gross income in his return as required by the Internal Revenue Code and regulations prescribed as necessary for carrying out the provisions of section 334 (b) (1). If the M Corporation failed to include the $75,000 in gross income in his return as required by the Internal Revenue Code and regulations prescribed as necessary for carrying out the provisions of section 334 (b) (1), the amount A would have to include in his gross income, proper adjustment being made to the basis of A's stock, as a result of such adjustment.

Example (2). In example (1) assume the basis of A's stock to be $200,000. If A included in gross income in his return for the calendar year 1942, $78,000 as a constructive dividend from the M Corporation, the basis of his stock would be $378,000. After the $78,000 is distributed by the M Corporation tax-free the basis of A's stock, assuming no other changes, would be $300,000 if A failed to include the $78,000 in gross income in his return as required by the Internal Revenue Code and regulations prescribed as necessary for carrying out the provisions of section 334 (b) (1). If the M Corporation failed to include the $78,000 in gross income in his return as required by the Internal Revenue Code and regulations prescribed as necessary for carrying out the provisions of section 334 (b) (1), the amount A would have to include in his gross income, proper adjustment being made to the basis of A's stock, as a result of such adjustment.

Example (3). In example (1) assume the basis of A's stock to be $200,000. If A included in gross income in his return for the calendar year 1942, $78,000 as a constructive dividend from the M Corporation, the basis of his stock would be $378,000. After the $78,000 is distributed by the M Corporation tax-free the basis of A's stock, assuming no other changes, would be $300,000 if A failed to include the $78,000 in gross income in his return as required by the Internal Revenue Code and regulations prescribed as necessary for carrying out the provisions of section 334 (b) (1). If the M Corporation failed to include the $78,000 in gross income in his return as required by the Internal Revenue Code and regulations prescribed as necessary for carrying out the provisions of section 334 (b) (1), the amount A would have to include in his gross income, proper adjustment being made to the basis of A's stock, as a result of such adjustment.

§ 29.337-2 Credit for obligations of the United States. Each United States shareholder required to return his distributive share in the undistributed Supplement P net income of a foreign personal holding company for any taxable year is allowed, for purposes of the tax imposed by section 11, 13, 14, 201, 204, 207, or 326, a credit against his net income for his proportionate share of whatever interest on obligations of the United States, and not for any part of the interest received by the foreign personal holding company which the United States shareholder in the foreign personal holding company as a dividend, treated as a payment of the specified dividend before any part may be allocated as a dividend on the preferred stock before any part may be allocated as a dividend on the common stock.

The nondistributive share of the required portion of the undistributed Supplement P net income must be returned as dividend income by the United States shareholders for their respective taxable years in which or with which the taxable year of the foreign personal holding company ends. For example, if the M Corporation whose taxable year is the calendar year is a foreign personal holding company and if A, a United States shareholder, makes returns on a calendar year basis, while B, another United States shareholder, makes returns on the basis of a fiscal year ending November 30, A must return his assumed dividend as income for the taxable year 1942, and B must return his distributive share as income for the fiscal year ending November 30, 1943. In applying this rule, the date as of which the United States group last existed with respect to the company is immaterial. Thus, in the foregoing example, if A, a United States shareholder, made returns on the basis of a fiscal year ending November 30, 1942, the last day on which the United States group with respect to the M Corporation existed, B would still be required to return his assumed dividend as income for the fiscal year ending November 30, 1942, even though September 30, 1942, the date as of which the distribution is assumed to have been made, does not fall within such fiscal year.
(a) Contents of return. The return shall, in accordance with the provisions of this section and the instructions on the form, set forth with respect to the preceding period following information:

(1) Name and address of corporation;
(2) Kind of business in which the corporation is engaged;
(3) Date of incorporation;
(4) The country under the laws of which the corporation was organized;
(5) Number of shares and par value of common stock of the corporation outstanding as of the beginning and end of the period;
(6) Number of shares and par value of preferred stock of the corporation outstanding as of the beginning and end of the period, the rate of dividend on such stock and whether such dividend is cumulative or noncumulative;
(7) A description of the convertible securities issued by the corporation, including a statement of the face value of, and rate of interest on, such securities;
(8) The name and address of each shareholder, the class and number of shares held by each, together with any changes in stock holdings during such period;
(9) The name and address of each holder of securities convertible into stock of the corporation, the class, number, and face value of the securities held by each, together with any changes in the holdings of such securities during the period;
(10) A certified copy of any resolution or plan, and any amendments thereof or supplements thereto, for or in respect of the dissolution of the corporation or the liquidation of the whole or any part of its capital stock; and
(11) Such other information as may be required by the return form.

If a person is required to file a return under section 338 (a) and this section with respect to more than one foreign corporation, a separate return must be filed with respect to each foreign corporation.

(d) Verification of returns. All returns required by section 338 (a) and this section shall be verified under oath or affirmation in the same manner as prescribed in § 29.51-4.

(e) Penalties. For criminal penalties for failure to file the returns required by section 338 (a) and this section, see section 340.

§ 29.338–3 Time and place of filing returns. Returns required by section 338 and §§ 29.338–1 and 29.338–3 shall be filed with the Commissioner of Internal Revenue, Washington, D. C., attention Income Tax Unit, Records Division, and will be considered filed within the time or times required by law if, within such time or times, such returns are made and placed in the mails in due course, properly addressed and postage paid, provided they are actually received in the office of the Commissioner of Internal Revenue, Washington, D. C., even though received after such time or times.

Sec. 339. Information returns by shareholders.

(a) Monthly returns. On the fifteenth day of each month each United States shareholder, by or for whom 50 per centum or more in value of the outstanding stock of a foreign corporation is owned directly or indirectly (including in the case of an individual, stock owned by the members of his family defined in section 333 (a) (1)), if such foreign corporation with respect to its taxable year preceding the taxable year (whether beginning on, before, or after January 1, 1939) in which the return was a foreign personal holding company, shall file with the Commissioner a return.
setting forth with respect to the preceding calendar month the name and address of each shareholder, the class and number of shares held by each, with any changes in stockholdings during such period, the name and address of any holder of securities convertible into or exchangeable for such stock or any holder of stock or securities of any other corporation the voting or dividend rights of which are exercisable by or are held by the holder of such common stock, and such other information with respect to the stock and securities of the corporation as the Commissioner of Internal Revenue may by regulations prescribe as necessary for carrying out the provisions of this title. The Commissioner, with the approval of the Treasury, may by regulations prescribe, as the period with respect to which returns shall be filed, a longer period than a month.

In such case the return shall be due on the fifteenth day of the succeeding period, and shall be filed by the persons on whom such day are United States shareholders.

(b) Annual returns. On the sixtieth day after the close of the taxable year of a foreign personal holding company each United States shareholder, by or for whom on such sixtieth day 50 percent or more in value of the outstanding stock of such company is owned directly or indirectly (including, in the case of an individual, stock owned by members of his family as defined in section 333 (a)), shall file with the Commissioner a return setting forth the same information with respect to such taxable year as is required in subsection (a); except that if all the returns required with respect to such taxable year have been filed under subsection (a) no return shall be required under this subsection.

§ 29.339-1 Information returns by shareholders of certain foreign corporations—(a) Requirement for filing returns—(1) General. On the 15th day of each month each United States shareholder, by or for whom on such sixtieth day 50 percent or more in value of the outstanding stock of a foreign corporation is owned directly or indirectly (including in the case of an individual, stock owned by members of his family as defined in section 333 (a) (21)), if such foreign corporation with respect to its taxable year preceding the taxable year in which such month occurs was a foreign personal holding company, shall file with the Commissioner a return setting forth fully and clearly the information called for therein and by the applicable regulations. Returns which have not been so prepared will not be considered as meeting the requirements of the Internal Revenue Code.

(c) Contents of return. The return shall, in accordance with the provisions of this section and the instructions on the form, set forth with respect to the preceding period the same information as required to be shown on such form by sections 338 (a) and 29.338-1 (c).

If a person is required to file a return under section 339 (a) and this section with respect to more than one foreign personal holding company, a separate return must be filed with respect to each foreign personal holding company.

(d) Verification of returns. All returns required by section 339 (a) and this section shall be verified under oath or affirmation in the same manner as prescribed in § 29.51-4.

(e) Penalties. For criminal penalties for failure to file the returns required by section 339 (a) and this section, see section 240.

§ 29.339-3 Time and place of filing returns. Returns required by section 339 and §§ 29.339-1 and 29.339-2 shall be filed with the Commissioner of Internal Revenue, Washington, D. C., attention: Internal Revenue Division, and will be considered filed within the time or times required by law if, within such time or times, such returns are made and placed in the mails in due course, properly addressed and postage paid, provided they are actually received in the office of the Commissioner of Internal Revenue, Washington, D. C., even though received after such time or times.

SEC. 390. Penalties. Returns required under section 338 or 339 to file a return, or to supply any information, who willfully fails to file such return, or to supply such information, may be fined not more than $10,000, or imprisoned for not more than one year, or both.

Regulated Investment Companies

SEC. 381. Definition [as amended by sec. 110 (a), Rev. Act 1942].

(a) General. For the purposes of this chapter, the term "regulated investment company" means any domestic corporation (whether charter or created as an investment trust, or otherwise) other than a personal holding company as defined in section 501, which at all times during the taxable year has not been regulated if investment companies, and whose gross income as derived from dividends, interest, and gains from the sale or other disposition of stocks or securities (other than those held or acquired as the owner of a foreign personal holding company, a separate return must be filed with respect to each foreign personal holding company.)

(b) Limited Trust. Despite the provisions of subsection (a), a corporation shall not be considered a regulated investment company for any taxable year unless—

(1) At least 80 per centum of its gross income is derived from dividends, interest, and gains from the sale or other disposition of stocks or securities (other than those held or acquired as the owner of a foreign personal holding company, a separate return must be filed with respect to each foreign personal holding company.)

(2) Less than 30 per centum of its gross income is derived from the sale or other disposition of stocks or securities held for less than three months; and

(3) Net income as defined in section 2 of such Act, net income as defined in section 3 of such Act, and net income as defined in section 6 of such Act, and placed in the mails in due course, properly addressed and postage paid, provided they are actually received in the office of the Commissioner of Internal Revenue, Washington, D. C., even though received after such time or times.

Regulated Investment Companies

SEC. 381. Definition [as amended by sec. 110 (a), Rev. Act 1942].

(a) General. For the purposes of this chapter, the term "regulated investment company" means any domestic corporation (whether charter or created as an investment trust, or otherwise) other than a personal holding company as defined in section 501, which at all times during the taxable year has not been regulated if investment companies, and whose gross income as derived from dividends, interest, and gains from the sale or other disposition of stocks or securities (other than those held or acquired as the owner of a foreign personal holding company, a separate return must be filed with respect to each foreign personal holding company.)

(b) Limited Trust. Despite the provisions of subsection (a), a corporation shall not be considered a regulated investment company for any taxable year unless—

(1) At least 80 per centum of its gross income is derived from dividends, interest, and gains from the sale or other disposition of stocks or securities (other than those held or acquired as the owner of a foreign personal holding company, a separate return must be filed with respect to each foreign personal holding company.)

(2) Less than 30 per centum of its gross income is derived from the sale or other disposition of stocks or securities held for less than three months; and

(3) At the close of each quarter of the taxable year (A) at least 80 per centum of the value of its total assets is represented by cash and cash items (including receivables), Government securities, securities of any regulated investment company, and other securities for the purposes of this calculation limited in respect of any one issuer or group of issuers in an amount not exceeding 6 per centum of the value of the total assets of the taxpayer and to not more than 10 per centum of the outstanding voting securities of such issuer or group of issuers, and (B) the value of its assets is invested in the securities (other than Gov-
erement securities (or the securities of other regulated investment companies) of any one issuer, or of two or more issuers which the taxpayer may have purchased, under regulations prescribed by the Commissioner with the approval of the Secretary, to be engaged in the same or similar businesses or branches of business. For the purposes of clause (B), in ascertaining the value of the taxpayer's investment in the securities of an issuer, there shall be included its proper proportion of the investment of any other corporation, a member of a controlled group, in the securities of such issuer, as determined under regulations prescribed by the Commissioner and approved by the Secretary. The term "controlled", as used in this context, means one or more chains of regulated investment companies (other than those of majority-owned subsidiaries for which market quotations are readily available, the market value of such securities; and with respect to other securities and assets, fair value as determined in good faith by the Commissioner or his delegate). In the case of securities of majority-owned subsidiaries which are investment companies such fair value is defined as the increased market value or asset value, whichever is higher. All other terms used in the preceding provisions of this paragraph shall have the same meaning as when used in the Investment Company Act of 1940, or that Act as amended. A corporation which meets the foregoing requirements of this paragraph at the close of any quarter shall not lose its status as a regulated investment company because of a discrepancy during a subsequent quarter between the value of its various investments and such requirements unless such discrepancy exists immediately after the acquisition of any security or other property which is included in such acquisition during such quarter shall not lose its status for such quarter as a regulated investment company if such discrepancy is eliminated within sixty days after the close of such quarter and in such cases it shall be considered to have met such requirements at the close of such quarter for the purposes of applying the preceding sentence. A corporation which meets such requirements at the close of a particular quarter of the taxable year and which reasonably believes that such discrepancy existing immediately after the acquisition of any security or other property which is included in such acquisition during such quarter shall not lose its status for such quarter as a regulated investment company if such discrepancy is eliminated within thirty days after the close of such quarter and in such cases it shall be deemed to have met such requirements at the close of such quarter, provided that at least 90 percent of the corporation's gross income for the taxable year shall be derived from dividends, interest, and gains from the sale or other disposition of stock or securities, and less than 50 percent of the corporation's gross income for the taxable year shall have been derived from the sale or other disposition of stock or securities held for less than three months. As to the definition of the term "investment", see sec. 301 (2). By determining the percentage of the corporation's gross income which has been derived from such sources, a loss from the sale or other disposition of stock or securities does not enter into the determination of the period for which stock or securities have been held. The term "controlled", "controlled group", and "value" are defined for the purposes of this paragraph in section 361 (b) (3). All terms used in this section have the same meaning as when used in the Investment Company Act of 1940, or that Act as amended. In determining the value of the investment company's investments in securities of any one issuer, there shall be included its proper proportion of the investment of any other corporation, a member of a controlled group, in the securities of such issuer. With respect to the effect which certain discrepancies between the value of its various investments and the requirements of section 361 (b) (3) of this title have on the status of a company as a regulated investment company for the purposes of these sections, see section 361 (b) (3). A company claiming to be a regulated investment company shall keep sufficient records as to its investments so as to be able to show that it has complied with the provisions of section 361 (b) (3) during the taxable year. Such records shall be kept at all times available for inspection by any authorized officer or employee of the Bureau of Internal Revenue and shall be retained as long as the company may be under the administration of any internal-revenue law.

The requirements as to diversification under section 361 (b) (3) are illustrated by the following examples:

Example (1). Investment Company W, at the close of its first quarter of the taxable year has its assets invested as follows: 5 percent in Corporation A, 15 percent in Corporation B, 10 percent in Corporation C, 20 percent in securities of regulated investment companies as defined in section 361 (b) (3), 20 percent in Corporation G, 20 percent in Corporation D, and the balance, 20 percent, in the securities of various corporations not exceeding 5 percent of its assets invested in any one company. Investment Company W owns 15 percent of the voting stock of Corporation G and less than 10 percent of the voting stock of the other corporations, except that it owns all of the voting stock of Corporations A and B. None of the corporations of which the company is a member of a controlled group. Investment Company W meets the requirements at the end of its first quarter under clause (A) of subsection (a) since it has 65 percent of its assets invested as provided in clause (A). If it complies with clause (B) since it does not have more than 5 percent of its assets invested in the securities of any one issuer, or of two or more issuers which it controls.

Example (2). Investment Company V, at the close of a particular quarter of the taxable year has its assets invested as follows: 10 percent in cash, 30 percent in Government securities, 7 percent in the securities of Corporation A, 12 percent in Corporation B, 10 percent in Corporation C, 15 percent in Corporation D. Investment Company V fails to meet the requirements of clause (A) of section 361 (b) (3) since its assets invested in Corporations A, B, D, and E exceed in
each case 5 percent of the value of the total assets of the company at the close of the particular quarter.

Example (5). Investment Company Z at the close of the particular quarter of the taxable year has assets invested in follows: 20 percent of its assets in Corporation A, 10 percent in Corporation B, 23 percent in Corporation C, and 40 percent in miscellaneous corporations, not exceeding 5 percent in any one issuer. Investment Company Z owns less than 20 percent of the voting power of all of the corporations, except it owns more than 20 percent of the voting power of Corporations B and C. Corporation K has 20 percent of its assets invested in Corporation B, and Corporation L has 5 percent of its assets invested in Corporation B. Corporation A. Corporation B and Corporation C act as its distributor and also distributes radios for other companies. Investment Company Z fails to meet the requirements of section 361(b) (3) since it has 35 percent of its assets invested in the securities of two issuers which it controls and which are engaged in related trades or businesses.

Example (4). Investment Company Y at the percentage of its assets invested in cash and Government securities, 30 percent in Corporation X, a regulated investment company, 10 percent in Corporation A, 20 percent in Corporation B, and the remaining 5 percent in various corporations in none of which is more than 20 percent of its assets invested. Corporation X has 20 percent of its assets invested in Corporation X, and Corporation Z has 40 percent of its assets invested in Corporation B. Corporation A also has 20 percent of its assets invested in Corporation B, and owns more than 20 percent of the voting power in Corporation B. Investment Company Y owns more than 20 percent of the voting power of Corporations A and E. Corporation K owns more than 20 percent of the voting power of Corporation L, and Corporation L owns more than 20 percent of the voting power in Corporation E. Investment Company Y is disqualified under clause (b) since more than 25 percent of its assets is considered invested in Corporation B as shown by the following calculation:

Percentage of assets invested directly in Corporation B, 20.
Percentage of assets invested through the controlled group, X—Y—L—B, 2.4, determined as follows:
40 percent of 20 percent of 30 percent—2.4.

Percentage invested in the controlled group, Y—A—B, determined by taking 20 percent of 10 percent.

Total percentage of assets of Investment Company B invested in Corporation B, 20 percent.

Example (5). Investment Company Z at the close of its first full quarter after October 31, 1943 (the date of commencement of the Revenue Act of 1943) meets the requirements of section 361(b) (3) and has 20 percent of its assets invested in Corporation A. Later during the taxable year it makes distributions to its shareholders and because of such distributions it finds at the close of the taxable year that it has more than 25 percent of the remaining assets invested in Corporation A. Investment Company Z does not lose its status as a regulated investment company because of such distributions. It is only possible for a regulated investment company in its return for the first taxable year to which it desires the election to be applicable. No other method of making such election is permitted. An election once made is irrevocable for the current taxable year and all succeeding taxable years.

§ 3262-2 Method of taxation of regulated investment companies. If a regulated investment company distributes during the taxable year to its shareholders as taxable dividends other than capital gain dividends an amount not less than 90 percent of its net income for the taxable year computed without regard to capital gains and capital loss deduction in computing its net income for any such taxable year, its taxable year is determined, earnings and profits of a regulated investment company, such earnings and profits shall not be reduced by any amount which is not allowable as a deduction in computing its net income for such taxable year. See section 362(a). Thus, if a corporation would have had earnings and profits of $300,000 for the taxable year except for the fact that it had a net capital loss of $100,000, which amount was not deductible in determining its net income, its earnings and profits for that year if it is a regulated investment company, would be $200,000. However, in determining its accumulated earnings and profits as of the beginning of the following taxable year, the earnings and profits for the preceding taxable year upon which such computation would amount to $400,000 assuming that there had been no distribution from such earnings and profits. For the purpose of the earnings and profits concept, it is immaterial whether during the taxable year a regulated investment company is taxable under Supplement Q.

§ 29.362-2 Earnings and profits of a regulated investment company. In the determination of the earnings and profits of a regulated investment company, such earnings and profits shall not be reduced by any amount which is not allowable as a deduction in computing its net income for such taxable year. See section 362(a). Thus, if a corporation would have had earnings and profits of $300,000 for the taxable year except for the fact that it had a net capital loss of $100,000, which amount was not deductible in determining its net income, its earnings and profits for that year if it is a regulated investment company, would be $200,000. However, in determining its accumulated earnings and profits as of the beginning of the following taxable year, the earnings and profits for the preceding taxable year upon which such computation would amount to $400,000 assuming that there had been no distribution from such earnings and profits. For the purpose of the earnings and profits concept, it is immaterial whether during the taxable year a regulated investment company is taxable under Supplement Q.
the application of section 363 (a) which are taxable in the hands of such shareholders and treated as if such transactions were covered by chapter 1. A taxable dividend is not distributed to its shareholders during the taxable year within the meaning of section 362 (b), unless the dividend is received by such shareholder within the period of 120 days following the close of the taxable year of the company. See § 29.27 (b)–2, relating to when dividends are considered paid. Due to the provisions in section 362 (a) with respect to the concept of earnings and profits of a regulated investment company, even though such a company has no accumulated earnings and profits if it makes distributions during the taxable year of an amount equal to its net income for that year, regardless of the amount of losses which are not deductible against such net income, it will be allowed a basic surtax credit equal to its net income, and thus not be liable for any income tax for the taxable year provided it otherwise satisfies the requirements of Supplement Q. The terms "Supplement Q net income," "Surplus gain income," and "capital gain dividend" are defined in section 362 (b) (1), (2), and (7), respectively.

§ 29.362–3 Records to be kept for purpose of determining whether a corporation or regulated investment company is a personal holding company. Every regulated investment company shall maintain in the collection district in which it is required to file its income tax return permanent records showing the information relative to the actual owners of its stock contained in the written statements required by these regulations to be demanded from the shareholders. The term "actual owner of stock," as used in these regulations, includes the person who is required to include in gross income in his return the dividends received on the stock. Such books shall be kept for a minimum of 4 years and shall be available at all times for inspection, by any authorized officer or employee of the Bureau of Internal Revenue, and shall be retained as long as the contents thereof may be necessary for the administration of any internal-revenue law.

For the purpose of determining whether a domestic corporation claiming to be a regulated investment company is a personal holding company as defined in section 501, the permanent records of the company shall show the maximum number of shares of the corporation (including the number and face value of securities convertible into stock of the corporation) to be considered as actually or constructively owned by each of the actual owners of any of its stock at any time during the last half of the corporation's taxable year, as provided in section 503. Statements giving such information shall be demanded not later than 30 days after the close of the corporation's fiscal year. The provisions of these regulations, whichever is later, as follows:

(a) In the case of a corporation having 2,000 or more record holders of its stock on any dividend record date, from each record holder of 5 percent or more of its stock;

(b) In the case of a corporation having less than 2,000 and more than 200 record holders of its stock on any dividend record date, from each record holder of 1 percent or more of its stock; or

(c) In the case of a corporation having 200 or less record owners of its stock, on any dividend record date, from each record holder of one-half of 1 percent or more of its stock.

§ 29.362–4 Additional information required in returns of shareholders. Any person who fails or refuses to comply with this requirement of a regulated investment company for the written statements which § 29.362–3 requires the company to demand from its shareholders shall submit as a part of the income tax return an inscription of the names and addresses of the transferees of such stock, the names and addresses of the transferees thereof;

(d) The names and addresses of the members of his family (as defined in section 502) and the names and addresses of persons from whom it was acquired;

(e) The dates of disposition of any such stock during such period and the names and addresses of the transferees thereof;

(f) The names and addresses of any corporation, partnership, association, or trust in which he had a beneficial interest; and the names and addresses of his partners, if any, in any partnership; and the names and addresses of the transferees of such stock, the names and addresses of the transferees thereof;

(g) The amount of each distribution of $1 per share.

Additional information received by the shareholders shall be included in the company's demand as a part of its records required by these regulations. A company which fails to keep such records shall, if the personal ownership of its outstanding stock as are required by these regulations, or which may be required by time to time by the Commissioner, with the approval of the Secretary, for such purpose, shall not be taxable as a regulated investment company.

Nothing in these regulations shall be construed to relieve regulated investment companies or their shareholders from the duty of filing information returns required by regulations prescribed under sections 147 and 148.

§ 29.362–5 Method of taxation of shareholders of regulated investment companies. Shareholders who receive capital gain dividends from a regulated investment company distributed during a taxable year of the regulated investment company for which it is taxable under section 363 (b) shall treat such dividends as gains from the sale or exchange of capital assets held for more than six months. A capital gain dividend is defined in section 29.362 (7) as any dividend or part thereof which is designated by a regulated investment company as a capital gain dividend in a written notice mailed to its shareholders at any time prior to the expiration of 30 days after the close of its taxable year. If the aggregate amount so designated with respect to the taxable year is greater than the excess of the net long-term capital gain over the net short-term capital loss of the taxable year, the portion of each distribution which shall be a capital gain dividend shall be only that portion which exceeds such excess of the net long-term capital gain over the net short-term capital loss.

EXCHANGES AND DISTRIBUTIONS IN COMPLIANCE TO ORDERS OF SECURITIES AND EXCHANGE COMMISSION

Sec. 371. NONRECOGNITION OF GAIN OR LOSS

(a) Exchanges of stocks or securities only. No gain or loss shall be recognized on the transactions of stock or securities which is a registered holding company or a majority-owned subsidiary company are transferred to such corporation or to an associate company thereof which is a registered holding company or a majority-owned sub-
propriate to the integration or simplification of the holding-company system of which the transferor corporation is a member.

(c) Distribution of stocks or securities only. If there is distributed, in obedience to an order of the Securities and Exchange Commission, to a shareholder in a corporation which is a registered holding company or a member of a system group, stock or securities (other than stock or securities which are nonexempt property), without the surrender by such shareholder of any stock or securities in such corporation, no gain to the distributee from the receipt of the stock or securities so distributed shall be recognized,

(b) Exchanges and sales of property by corporations. No gain shall be recognized to a transferor corporation which transfers to an associated company of a registered holding company, if such corporation, in obedience to an order of the Securities and Exchange Commission, transfers property in exchange for property, and such order recites that such exchange by the transferor corporation is necessary or appropriate to the integration or simplification of the holding-company system of which the transferor corporation is a member. If any such property so received is nonexempt property, gain shall be recognized unless such nonexempt property or an amount equal to the fair market value of such property at the time of the transfer is, within 24 months of the transfer, under regulations prescribed by the Secretary, and in accordance with an order of the Securities and Exchange Commission, transferred to an exchange, expenditure, investment, distribution, or sale, unless (1) the order of the Securities and Exchange Commission is in obedience to which such exchange, expenditure, investment, distribution, or sale was made in accordance with an order of the Securities and Exchange Commission, or (2) there is distributed, in obedience to such order, stock or securities which are nonexempt property or appropriate to effectuate the provisions of subsection (b) of the Public Utility Holding Company Act of 1935, 49 Stat. 786 (U. S. C. title 15, sect. 79k (b)), (2) such order specifies and itemizes the stock and securities and other property which are to be transferred, received, or sold upon such exchange, acquisition, expenditure, distribution, or sale, and in the case of an acquisition, the investment to be made, and (3) of the terms of such order. Such order shall be completed within the time prescribed therefore.

(d) Non-application of other provisions. If an exchange or distribution made in obedience to an order of the Securities and Exchange Commission is not within any of the provisions of this section and may also be considered to be within any of the provisions of section 112 (other than paragraphs (a) and (b) of paragraph (b) of subsection (b)), then the provisions of this section only shall apply.

§ 23.371-0 Terms used. The following terms are defined in section 371 and when used in this section and § 29.371-1 (a) to (d), and mean the meanings therein assigned to them: "Order of the Securities and Exchange Commission"; "registered holding company"; "holding-company system"; "majority-owned subsidiary company"; "nonexempt property"; and "stock or securities." Any other term used in this section and § 29.371-1, inclusive, which is defined in the Internal Revenue Code, shall be given the respective definition contained in the Code.

§ 23.371-1 Purpose and scope of excise. The general purpose of this section is to determine the entire amount of gain or loss from the sale or exchange of property of a corporation which is to be recognized (see section 112 (a)) and that the entire amount received as a dividend is included in computing the gain or loss (see sections 22 (a) and 115). Exceptions to the general rule are provided in section 112, one of which is that made by section 112 (b) (8) with respect to exchanges, sales, and distributions specifically described in section 371. Section 371 provides the extent to which gain or loss is not to be recognized on an exchange or sale, or the receipt of property on exchange, and when such exchange or sale shall be treated as an exchange, expenditure, investment, distribution, or sale. The order of the Securities and Exchange Commission must be one requiring or approving action which the Commission finds to be necessary or appropriate to effect a simplification or

Closing parenthesis evidently intended.
§ 29.371-2 Exchanges of stock or securities solely for stock or securities. The transfer of (a) nonrecognition of gain or loss, that is provided for in section 371 (a) must be one in which stock or securities in a corporation which is a registered holding company or a majority-owned subsidiary company are exchanged for stock or securities.

(b) The exchange that is provided for in section 371 (b), in which a registered holding company or an associate company of a registered holding company exchanges property for property.

c) The distribution that is provided for in section 371 (d), in which a corporation which is a member of a system group transfers property to another member of the same system group.

Certain rules with respect to the receipt of nonexempt property on an exchange are provided in section 371 (a) are prescribed in section 371 (e).

These new exceptions to the general rule are to be strictly construed as in the case of the other exceptions in section 112. The purpose is made clear by the specific requirements of Supplement R (sections 371 to 373, inclusive) are clearly set forth in this section. In any case to obtain or loss other than that realized from and directly attributable to a disposition of property as such, or the receipt of a corporate distribution as such, an exchange, sale, or distribution specifically described in section 371.

The application of the provisions of Supplement R (sections 371 to 373, inclusive) is intended to result only in postponing the recognition of gain or loss until a disposition of property is made which is not covered by such provisions, and, in the case of an exchange or sale subject to the provisions of section 371 (b), in the reduction of basis of certain property. The provisions of section 372 with respect to the continuation of basis and the reduction in basis are designed to effect the desired purpose. Although the time for the recognition of gain or loss may be shifted, there must be a true reflection of income in all cases, and it is intended that the provisions of Supplement R shall not be construed or applied in such a way as to defeat this purpose.
§ 29.371-4 Distribution solely of stock or securities. If, without any surrender of stock or securities as defined in section 371 (f), a shareholder in a corporation which is a registered holding company or an majority-owned subsidiary company receives stock or securities in such corporation, no gain to the shareholder will be recognized with respect to the stock or securities received by such shareholder which do not constitute nonexempt property. The distribution to such shareholder is made by the distributing corporation in obedience to an order of the Securities and Exchange Commission directed to such corporation. A distribution is not within the provisions of section 371 (c) if it is within the provisions of section 371 (d), relating to transfers within a system group. A distribution is also not within the provisions of section 371 (c) if it involves a surrender by the shareholder of stock or securities or a transfer by the shareholder of property in exchange for the stock or securities received by the shareholder, subject to further limitations, see section 371 (f).

§ 29.371-5 Transfers within system group. The nonrecognition of gain or loss provided for in section 371 (d) (1) is applicable to an exchange of property for other property (including money and other nonexempt property) is distributed to such corporation as a shareholder in a corporation which is a member of the same system group, without the surrender of stock or securities or a transfer by the shareholder or other party not a member of the system group, even though such obligations are transferred to it had been available to the B Corporation if the property transferred to it had been available to the B Corporation if it were not for the fact that an amount not in excess of the aggregate of:(1) The amount of gain which would be recognized under paragraph (d) if there were no reduction of basis under section 372 (a) (2); and (2) The amount of gain which cannot be applied in reduction of basis under section 372 (a) (2).

(g) Requirements with respect to expenditures or investment. If the full amount of the expenditure or investment required for the application of paragraph (c) of this section has not been made by the date of the taxable year in which such exchange occurred, the taxpayer shall file with the return for such year an application for the benefit of the 24-month period for expenditure and investment, reciting the nature and time of the proposed expenditure or investment. When requested by the Commissioner, the taxpayer shall execute and file (at such time and in such form) such waiver of the statute of limitations with respect to the time of filing of such document for the taxable year of the transfer and for all succeeding taxable years in any of which falls any part of the period beginning with the date of the transfer and ending 24 months thereafter (as the Commissioner may specify, and such bond with such surety as the Commissioner may require in an amount not in excess of double the estimated maximum amount of expenses or profits taxes which would be payable if the corporation does not make the required expenditure or investment within the required 24-month period.

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If money or other nonexempt property is received from a corporation in an exchange described in this section and if the distribution of such money or other nonexempt property by or on behalf of such corporation has the effect of the distribution of a taxable dividend, then, as provided in section 371 (g) (2), there shall be taxable to each distributee (1) as a dividend, such amount of the gain recognized on the exchange as is in excess of the distributee's ratable share of the fair market value of the gain so recognized of the corporation accumulated after February 28, 1913, and (2) the remainder of the gain so recognized shall be taxed as a gain from the exchange of property.

§ 29.371-9 Requirements with respect to order of securities and exchange commission. The term "order of the Securities and Exchange Commission" is defined in section 373 (a). In addition to the requirements specified in that definition, section 371 (f) provides that the provisions of section 371 shall apply to an exchange, expenditure, investment, distribution, or sale unless each of the following requirements is met:

(a) The order of the Securities and Exchange Commission shall state that the exchange, expenditure, investment, distribution, or sale is necessary or appropriate to effectuate the provisions of section 11 (b) of the Public Utility Holding Company Act of 1935.

(b) The order shall specify and itemize the stocks and securities and other property (including money) which are or will be acquired, transferred, received, or otherwise disposed of in such exchange, expenditure, investment, distribution, or sale, and, in the case of an investment, the investment to be made, so as clearly to identify such property.

(c) The order shall state the amount, if any, of the gain, if any, to the taxpayer or other person (including money) realized upon the exchange, expenditure, investment, distribution, or sale which is to be recognized or not recognized to the extent provided for by the order of the Securities and Exchange Commission described in this section and if Supplement R had not been enacted.

§ 29.371-10 Records to be kept and information to be filed with returns. (a) Every holder of stock or securities who receives stock or securities and other property (including money) from a corporation in an exchange described in this section shall, if the exchange is made with a corporation acting in obedience to an order of the Securities and Exchange Commission, file a part of his income tax return for the taxable year in which the exchange takes place a complete statement of all facts pertinent to the nonrecognition of gain or loss upon such exchange, including:

(1) A clear description of the stock or securities transferred in the exchange, together with a statement of the cost or other basis of such stock or securities.

(2) The name and address of the corporation from which the stock or securities were received in the exchange.

(3) A statement of the amount of stock or securities and other property (including money) received from the exchange.

The amount of each kind of stock or securities and other property received shall be set forth upon the basis of the fair market value thereof at the date of the exchange.

(b) Each corporation which is a party to an exchange made in obedience to an order of the Securities and Exchange Commission directed to such corporation shall file as a part of its income tax return for its taxable year in which the exchange takes place a complete statement of all facts pertinent to the nonrecognition of gain or loss upon such exchange, including:

(1) A copy of the order of the Securities and Exchange Commission directed to such corporation, in obedience to which the exchange was made.

(2) Certified copy of the corporate resolution authorizing the exchange.

(3) A clear description of all property, including all stock or securities, transferred in the exchange, together with a complete statement of the cost or other basis of each class of property.

(4) The date of acquisition of any stock or securities transferred in the exchange, and, if any of such stock or securities were acquired by the corporation in obedience to an order of the Securities and Exchange Commission, a copy of such order.
The name and address of all persons to whom any property was transferred shall be stated on the basis of the fair market value thereof at the date of the distribution.

(1) A copy of the order of the Securities and Exchange Commission, in obedience to which the distribution was made.

(2) A certified copy of the corporate resolution authorizing the distribution.

(3) A statement of the amount of stock or securities or other property (including money) distributed to each shareholder. The amount of each kind of stock or securities or other property shall be stated on the basis of the fair market value thereof at the date of the distribution.

(4) The date of acquisition of the stock or securities distributed, and, if any such stock or securities were acquired by the distributing corporation, a copy of such order.

(5) A statement showing as to each kind of stock or securities or other property (including money) received upon the exchange, including a statement of all facts pertinent to the nonrecognition of gain or loss from a subsequent disposition of such stock or securities and other property received on the exchange or distribution.

SEC. 372. BASIS FOR DETERMINATION OF GAIN OR LOSS IN CASE OF SECTION 371 (a) PROCEEDINGS.

(a) Exchanges generally—(1) Exchanges subject to the provisions of section 371 (c).

If the property was acquired upon an exchange subject to the provisions of section 371 (c), then (a) or (b), the basis shall be the same as in the case of the property exchanged, decreased by the amount of any money paid by the taxpayer and increased in the amount of gain or loss in the amount of loss to the taxpayer that was recognized upon such exchange subject to the provisions of section 371 (c) to be received without the recognition of gain or loss, and in part of noncapital property, the basis provided in this subsection shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to each such noncapital property (other than money) an amount equivalent to its fair market value at the date of the exchange. This subsection shall not apply to property acquired by a corporation by the issuance of its stock or securities as consideration in whole or in part for the transfer of the property to it.

(2) Exchanges subject to the provisions of section 371 (b). The gain not recognized under section 371 (b) shall be applied to reduce the basis for determining gain or loss on sale or exchange of the following categories of property in the hands of the transferor (other than the tax-exempt transferor), and property acquired within 24 months after such transfer by an expenditure or investment to which section 371 (b) relates on account of the acquisition of which gain is not recognized under such subsection, in the following order:

(1) Property of a character subject to the allowance for depreciation under section 23.

(2) Property (not described in paragraph (1)) with respect to which a deduction for amortization is allowable under section 23.

(3) Property with respect to which a deduction for depletion is allowable under section 23 (m) but not allowable under section 115 (b) (2), (3), or (4).

(4) Stock and securities of corporations not members of the system group of which the transferor is a member (other than stock or securities of a corporation of which the transferor is a subsidiary);

(5) Securities (other than stock) of corporations which are members of the system group of which the transferor is a member (other than securities of the transferor or of a corporation of which the transferor is a subsidiary);
(6) Stock of corporations which are members of the system group of which the transferor is a member (other than stock of the transferor or of a corporation of which the transferor is a subsidiary);

(7) All other remaining property of the transferor not divided under paragraphs (1) through (6) inclusive, determined in the manner and amount required by paragraph (7) of this section in the basis of the property transferred to the transferee.

The manner and amount of the reduction to be applied to particular property within any of the categories described in paragraphs (1) through (7) inclusive, shall be determined by regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury. Prior to its amendment by section 371 (e), Rev. Act 1942, section 372 (a) provided that in any taxable year beginning after January 1, 1942, in any manner described in section 372 (a), prior to its amendment by the Revenue Act of 1942, the basis shall be that pro-
dvided in such section. If the property acquired upon an exchange subject to the provisions of section 371 (a), (b), or (e), the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer, and increased in the amount of gain or decreased in the amount of a loss, the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. In case of property so acquired, a part of the property so acquired consisted in part of the type of property permitted by section 371(a) or (b) to be received without the recognition of gain or loss, and in exempt property the basis provided in this subsection shall be al-
located between the properties (other than money) received in proportion to their fair market values at the date of the exchange. This subsection shall not apply to property acquired by a corporation by the issuance of its stock or securities or in consideration in whole or in part for the transfer of the property to it.

(b) Transfers to corporations. If, in connection with a transfer subject to the provisions of section 371 (a), (b), or (e), the property was acquired by a corporation, either as paid-in surplus or as a contribution to capital, or in consideration for stock or securities issued by the corporation receiving the property (including cases where part of the consideration for the transfer of such property to the corporation consisted of property or money in addition to such stock or securities), then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

(c) Distributions of stock or securities. If the stock or securities were received in a distribution subject to the provisions of section 371 (c), then the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed.

(d) Transfers within system group. If the property was acquired by a corporation which is a member of a system group of which the transferor is a member, except that if stock in property is stock or securities issued by the corporation from which such stock or securities were received and they were issued (1) as the sole consideration for the property transferred to such corporation, then the basis of such stock or securities shall be either (A) an amount which bears the same ratio to the basis of the property transferred of the fair market value of such stock or securities at the time of their receipt bears to the total fair market value of the entire consideration received, or (B) the fair market value of such stock or securities at the time of their receipt, whichever is the lower; or (2) as part consideration for the property transferred to such corporation, then the basis of such stock or securities shall be either (A) an amount which bears the same ratio to the basis of the property transferred of the fair market value of such stock or securities at the time of the receipt bears to the total fair market value of the entire consideration received, or (B) the fair market value of such stock or securities at the time of their receipt, whichever is the lower.

§ 29.372-0 Basis for determining gain or loss. Section 113 (a) (17) provides that if property is transferred in a taxable year beginning after January 1, 1942, in any manner described in section 372, prior to its amendment by the Revenue Act of 1942, the basis shall be that pro-
dvided in such section. If the property acquired upon an exchange subject to the provisions of section 371 (a), (b), or (e), the basis shall be that prescribed in such section (after its amendment by such Act) with respect to such property. Section 372 therefore expands section 113 (a) in order to make adequate provisions with respect to the basis of property acquired in a transfer made in obedience to any of the provisions of section 112 (b) (8) and Exchange Commission in connection with which the recognition of gain or loss is prohibited by the provisions of section 112 (b) (8) and section 371 with respect to the whole or any part of the property received. In general and except as provided in 29.372-2, it is intended that the basis for determining gain or loss pertaining to the property prior to its transfer, as well as the basis for deter-
mining the amount of depreciation or depletion deductible and the amount of earnings or profits available for distribu-
tion, shall continue notwithstanding any change in the ownership of the asset in form or its change in ownership. The continuance of the basis may be reflected in a shift thereof from one asset to another in the hands of the same owner, or in its transfer with the property from one owner into the hands of another. See also § 29.371-1.

§ 29.372-1 Basis of property acquired upon exchanges under section 371 (a), (b) (prior to amendment by the Revenue Act of 1942), or (e). In the case of an exchange of stock or securities for stock or securities as described in section 371 (a), or an exchange of property for property as described in section 371 (b), or an exchange of property as described in section 371 (e) by the Revenue Act of 1942 and in a taxable year beginning prior to January 1, 1942, if no part of the gain or loss upon such exchange was recognized under section 371, the basis of the property acquired is the same as the basis of the property transferred by the taxpayer with proper ad-
justments to the date of the exchange. If, upon such exchange, there was received by the taxpayer money or other nonexempt property (not permitted to be received without the recognition of gain), and the amount of such money received and increased in the amount of gain recognized, must be apportioned to and is the basis of the properties (other than money) received on the exchange. For the purpose of the allocation of such basis to the properties received, there must be assigned to the nonexempt property (other than money) an amount equivalent to its fair market value at the date of the exchange.

§ 29.372-2 Reduction of basis of property by reason of gain not recognized under section 371 (b) — (a) Introductory. In addition to the adjustments provided in section 113 (b), and the sections of these regulations relating thereto, which are required to be made with respect to the cost or other basis of property, section 372 (a) provides that a further adjustment shall be made in any case in which there shall have been a non-
recognition of gain under section 371 (b), realized in a taxable year beginning after December 31, 1941. Such further adjustment shall be made with respect to the basis of the property in the hands of the transferor immediately after the transfer and of the property acquired within 24 months after such transfer by the transferee, and in the case of the property acquired under section 371 (b) relates, and on account of which expenditure or investment gain is not recognized. If the property is in
the hands of the transferor immediately
after the transfer, the time of reduction
is the day of the transfer; in all other
cases the time of reduction is the date
of acquisition. The effect of applying an
amount in reduction of basis under such
subsection is to reduce by such amount the basis for deter-
mining gain upon sale or other disposition, the basis for deter-
mising loss upon sale or other disposition, the basis for depre-
ciation and for depletion, and any other
amount which the Internal Revenue Code prescribes shall be the same as any
of such bases. For the purposes of the
determination of basis in reduction of
basis under such subsection, property
is not considered as having a basis capa-
bile of reduction if:
(1) It is money, or
(2) If its adjusted basis for deter-
mising gain at the time the reduction is to
be made is zero, or becomes zero at any
time in the application of such subsection.

(b) General rule. Section 372 (a) (2)
sets forth seven categories of property,
the basis of which for determining gain or
loss shall be reduced in the order stated.
The first category consists of all prop-
erty of a character subject to the allow-
ance for depreciation under section 23
(1) which is either in the hands of the
transferor immediately after the trans-
fer, or held for more than 24 months
after such transfer by an expenditure or
investment resulting in the nonrecognition
in whole or in part of gain, under section
371 (b). If any of the property in such
category has a basis capable of reduc-
tion, the reduction must first be made
before applying an amount in reduction
of the basis of any property in the second
or in a succeeding category, to each of
which in turn a similar rule is applied.

In the application of the rule to each
category, the amount of the gain not
recognized shall be applied to reduce the
cost or other basis of all the property in
the category. The cost or other basis
(basis at the time immediately after the
transfer or, if the property is not then
held but is thereafter acquired, at the
time of such acquisition) of each unit of
property in the first category shall be
decreased (but the amount of the de-
crease shall not be more than the amount
of the adjusted basis at such time for
determining gain, determined without
regard to this section) in amount equal
to such proportion of the unrecognized

gain as the adjusted basis (for
determining gain, determined without
regard to this section) at such time of
each unit of property of the taxpayer in
category bears to the aggregate of the
adjusted basis (for determining gain,
computed without regard to this section)
at such time of any property in the
taxpayer in that category. When such
adjusted basis of the property in the
first category has been thus reduced to
zero, a similar rule shall be applied, with
respect to the portion of such gain which
is unabsorbed in such reduction of the
basis of the property in such category,
in reducing the basis of the property in
the second category. A similar rule with
respect to the remaining unabsorbed gain
shall be applied in reducing the basis
of the property in the next succeeding
category.

(c) Special cases. With the consent of
the Commissioner, the taxpayer may,
however, recognize such portions of the
property in various categories of the
same property or securities for stock or
securities as contribution of capital or
surplus, or in consideration for its own
stock or securities. If, in connection with an exchange of stock or
securities for stock or securities as
described in section 371 (b), or an ex-
change of property for property as de-
scribed in section 371 (b), or an ex-
cchange as described in section 371 (d),
property is acquired by a corporation by
the issuance of stock or securities of
such corporation, the basis of such property shall be deter-
mined under section 372 (b). If the
property issued as stock or securities
is part or sole consideration for the
property acquired, the basis of the prop-
erty in the hands of the acquiring cor-
poration is the basis (adjusted to the
date of the exchange) which the prop-
erty would have had in the hands of
the transferor if the transfer had not
been made, increased in the amount of
gain or decreased in the amount of loss
recognized under section 371 to the
transferor or upon distribution or
transfer by the transferor or distributee.

§ 29.372-4 Basis of stock or securities
acquired by shareholder based on tax-free
distribution under section 371 (c). Under
section 372 (c), if there was distrib-
uted to a shareholder in a corporation
which is a registered holding company
or a majority-owned subsidiary company
stock or securities (other than stock or
securities which are nonexempt prop-
erty), and by virtue of section 371 (c)
was not at the time of such distribution
made to the shareholder upon such
distribution, then the basis of the stock
in respect of which the distribution was
made must be apportioned between stock
and the stock or securities so distributed
to the shareholder, in accordance with
the rule of section 371 (c) (3). The basis
of the old shares and the stock or securities received upon the
distribution shall be determined in ac-
cordance with the following rules:

(1) If the stock or securities received
upon the distribution consist solely of
stock in the distributing corporation
and the stock received is all of substantially
the same character and preference as
the old shares the basis of each share
will be the quotient of the cost or other
basis of the old shares of stock divided
by the total number of the old and the new
shares.

(b) If the stock or securities received
upon the distribution are in whole or in
part stock in a corporation other than
the distributing corporation, the basis in
whole or in part of stock of a character
or preference materially different from the
stock in respect of which the distribution
was made, or if the distribution consists
in stock and stock of a character or
preference materially different from the
stock in respect of which the distribution
was made, or if the stock or securities
distributed in proportion, as nearly as may
be, to the respective values of each class
of stock or security, old and new, at the
time of such distribution, and the basis
of each share of stock or unit of security
will be the quotient of the cost or other
basis of the class of stock or security to
which such share or unit belongs, divided
by the number of shares or units in
the class.

Within the meaning of the fore-
going provisions stock or securities in
one corporation are different in class
from stocks or securities in another cor-
poration, and, in general, any material
difference in character or preference;
stock or securities of a corporation
from another stock or security from another stock or securities in another corpo-
rator; or, in general, any material
difference in character or preference; stock
or securities of a corporation
from another stock or security
so that different values may properly be
assigned thereto, will constitute a dif-
nence in class. As to the basis of stock
or securities distributed by one member
of a system group to another member
of the same system group, see section
372 (d).

§ 29.372-5 Basis of property acquired
under section 371 (d). In transactions
between corporations of the same sys-

tem group. If property was acquired
by a corporation which is a member of
a system group, from a corporation which
is a member of the same system group,
upon a transfer or distribution described
in section 371 (d) (1), then as a general
rule the basis of such property in the
hands of the acquiring corporation is
the basis which such property would
have had in the hands of the transferor
if the transfer or distribution had not
been made.

- Except as otherwise indicated in this
section, this rule will apply equally to
cases in which the consideration for the property acquired consists of stock or securities, money, and other property, or any of them, but it is contemplated that an ultimate true reflection of income will be obtained, notwithstanding any peculiarities in form which the various transactions may assume. See the example in § 28.371–5.

An exception to this general rule is provided for in the case where the property acquired consists of stocks or securities issued by the corporation from which such stock or securities were received. If such stock or securities were the sole consideration for the property transferred to the corporation issuing such stock or securities, then the basis of the stock or securities shall be (1) the same as the basis (adjusted to the time of the transfer) of the property transferred for such stock or securities, or (2) the fair market value of such stock or securities at the time of their receipt, whichever is the lower. If such stock or securities constituted a substantial part of the consideration for the property transferred to the corporation issuing such stock or securities, then the basis shall be an amount which bears the same ratio to the basis of the property transferred as the fair market value of such stock or securities on their receipt bears to the total fair market value of the entire consideration received, except that the fair market value of such stock or securities at the time of their receipt shall be the basis thereof, if such value is lower than such amount.

Example. Suppose the A Corporation has property with an adjusted basis of $600,000 and in an exchange to which section 271 (d) (1) is applicable, transfers such property to the B Corporation in exchange for a total consideration of $1,100,000 consisting of (1) cash in the amount of $600,000, (2) tangible property having a fair market value of $400,000 and an adjusted basis in the hands of the B Corporation of $300,000, and (3) stock or securities issued by the B Corporation with a par value and fair market value as of the date of their receipt of $200,000 each, and the basis in the hands of the A Corporation was $600,000. The basis to the B Corporation of the property received by it is $600,000, which is the adjusted basis of the property transferred. The basis to the B Corporation of the stock or securities issued by the B Corporation to the A Corporation is the par value of the stock or securities $200,000 each, and the basis to the A Corporation of the assets (other than cash) received by it is as follows: Tangible property, $600,000; stock or securities issued by the B Corporation, $800,000, an amount equal to $600,000/1,000,000ths of $600,000.

Suppose that the property of the A Corporation transferred to the B Corporation had an adjusted basis of $614,000 in the hands of $800,000, and that-all other factors in the illustration in the preceding paragraph remain the same as in the case the property to the A Corporation of the stock or securities in the B Corporation is $500,000, which was the fair market value of such stock or securities at the time of their receipt by the A Corporation, and not the amount established as $600,000/1,000,000ths of $414,000, or $500,000.

Sec. 373. Definitions—[as amended by sec. 221 (e), Rev. Act 1939, sec. 117 (b), Rev. Act 1941; sec. 171 (d) (e) (f), Rev. Act 1942].

(a) The term "order of the Securities and Exchange Commission" means an order issued after May 26, 1938, by the Securities and Exchange Commission, which authorizes, permits, or approves transactions described in such order to effectuate the provisions of title 15 of the Public Utility Holding Company Act of 1935, 49 Stat. 820 (U.S.C. title 15, sec. 79b), which becomes or becomes final in accordance with law.

(b) The term "registered holding company", "holding-company system", and "associate company" shall have the meanings assigned to them by section 2 of the Public Utility Holding Company Act of 1935, 49 Stat. 804 (U.S.C., Supp. III, title 15, 1938). (c) The term "majority-owned subsidiary company" of a registered holding company means a corporation, stock of which, repre- senting in aggregate more than 50% of the total voting power of all classes of stock of such corporation entitled to vote (not including stock which is entitled to vote only upon default or non- payment of dividends or other special circum- stances) is owned wholly by such regis- tered holding company, or partly by such registered holding company and one or more majority-owned subsidiary companies thereof, or by one or more majority-owned subsidiary companies of such registered holding company. (d) The term "system group" means one or more chains of corporations connected through stock ownership with a common parent corporation if—

(1) At least 90 per centum of each class of the stock of each corporation (except the common parent corporation) is owned directly or indirectly by one or more of the member companies of the system group; or

(2) The common parent corporation owns directly or indirectly 50 per centum or more of the total voting power of each of the corporations in the system group; or

(3) Each of the corporations (except the common parent corporation) is either a registered holding company or a majority-owned subsidiary company. (e) The term "nonexempt property" means—

(1) Any consideration in the form of evidences of indebtedness owed by the transferor to the transferee or any and any or any and any of debts or other liabilities of the transferor (including a continuity of encumbrances subject to which the property transferred) or

(2) Short-term obligations (including notes, drafts, bills of exchange, and bankers' acceptances) having a maturity at the time of issuance of not more than forty months, exclusive of days of grace; or

(3) Securities issued or guaranteed as to principal or interest by a government or subsidiary division thereof, or an international financial agency, or a registered holding company or an associate company of a registered holding company which acquired such stock or securities after February 28, 1938, unless such stock or securities (other than obligations described in such order or permitted in paragraph (1), (2), or (3) above) is tendered in obedi- ence to an order of the Securities and Ex- change Commission or were acquired with- out the authorization of the Securities and Exchange Commission or under any section of the Public Utility Holding Company Act of 1935, 49 Stat. 820 (U.S.C. title 15, sec. 79k (b)).

(f) Money, and the right to receive money not evidenced by a security other than an obligation described in paragraph (2) or (3).

(g) The term "stock or securities" means shares of stock or any corporation, certificates of stock or interest in any corporation, notes, bonds, debentures, and evidences of indebtedness (including any evidence of an interest in or right to subscribe to or purchase any of the foregoing).
pany. Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to change any change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a holding company.

The Commission may by order revoke or modify any order previously made under this subsection, if, after notice and opportunity for hearing, it finds that the circumstances upon which the order was predicated do not exist. Any order made under this subsection shall be subject to judicial review as provided in section 24.

Section 11 (e) of the Public Utility Holding Company Act of 1935 provides:

(e) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit to the Commission a notification of registration, in such form as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers.

The term “holding-company system,” and “associate company.” The term “majority-owned subsidiary company” is defined in section 373 (c). Direct ownership by a registered holding company of any subsidiary company of a holding company is not necessary to constitute such corporation a majority-owned subsidiary company. Under section 2 (a) (14) of the Public Utility Holding Company Act of 1935, a registered holding company, owns 51 percent of the common stock of the A Corporation and 31 percent of the common stock of the B Corporation, the A Corporation owns 50 percent of the common stock of the B Corporation (the common stock in each case being the only stock entitled to vote), both the A Corporation and the B Corporation are majority-owned subsidiary companies.

(b) “Registered holding company,” “holding-company system,” and “associate company.” Under section 6 of the Public Utility Holding Company Act of 1935 any holding company may register by filing with the Securities and Exchange Commission a notice of registration, in such form as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers. A holding company shall be deemed to be subject to this section 11 (e) of the Public Utility Holding Company Act of 1935 any holding company which, upon the receipt of the Securities and Exchange Commission of such notification of registration, the term “registered holding company” as used in these regulations includes any company whose notification of registration has been so received and whose registration is still in effect under section 19 of the Public Utility Holding Company Act of 1935.

Under section 2 (a) (7) of the Public Utility Holding Company Act of 1935, a corporation is a holding company unless it is by this Act or by the Securities and Exchange Commission determined, by action of such corporation directly or indirectly exercised (either alone or pursuant to an arrangement or understanding with one or more other persons) such a controlling influence over the management or policies of any public-utility company (i.e., an electric utility company or a gas utility company as defined by such Act) or holding company as to make it necessary or appropriate in the public interest or for the protection of investors or consumers that such corporation be subject to the jurisdiction and regulations imposed upon holding companies by the Public Utility Holding Company Act of 1935. An electric utility company is defined by section 2 (a) (3) of the Public Utility Holding Company Act of 1935 to mean a company which owns or operates facilities used for the generation, transmission, or distribution of electrical energy for sale, other than sale to tenants or employees of the company operating such facilities for their own use and not for resale; and a gas utility company is defined by section 2 (a) (4) of such Act to mean a company which owns or operates facilities used for the distribution at retail (other than distribution only in enclosed portable containers, or distribution to tenants or employees of the company operating such facilities for their own use and not for resale) of natural or manufactured gas for heat, light, or power. However, under certain conditions the Securities and Exchange Commission may declare a company not to be an electric utility company or a gas utility company, as the case may be, in which event the company shall not be considered an electric utility company or a gas utility company.

The term “holding-company system” has the meaning assigned to it by section 2 (a) (9) of the Public Utility Holding Company Act of 1935, and hence means any holding company, together with all its subsidiary companies (i.e., subsidiary companies within the meaning of section 2 (a) (8) of such Act, which in general include one or more chains of corporations; and hence means any change in the voting securities of which outstanding voting securities is owned directly or indirectly by such holding company) and all mutual service companies of which such holding company or any subsidiary company thereof is a member company. The term “mutual service company” means a company as a mutual service company under section 13 of the Public Utility Holding Company Act of 1935. The term “member company” is defined by section 2 (a) (14) of the Public Utility Holding Company Act of 1935, and hence an associate company of a company is any company in the same holding-company system connected through stock ownership with a common parent corporation, if at least 50 percent of each class of stock (other than stock preferred as to both dividends and assets) of each of the corporations of which such holding company or any subsidiary company is majority-owned is owned directly by one or more of the other corporations and the common parent corporation owns directly at least 50 percent of each class of stock of at least one of the other corporations; but no corporation is a member of a system group if it is not either a registered holding company or a majority-owned subsidiary company.

The term “nonexempt property.” The term “nonexempt property” is defined by section 373 (e) to include:

(1) The amount of any consideration in the form of a cancellation or asump-
A Corporation; or

A Corporation receives $100,000 of nonexempt of indebtedness owned by the 

To illustrate, if in obedience to an order of the Securities and Exchange Commission the X Corporation, a registered holding company, transfers property to the Y Corporation in exchange for property (not nonexempt property) with a fair market value of $500,000, the X Corporation receives $100,000 of nonexempt property, if for example:

(i) The Y Corporation cancels $100,000 of indebtedness owed to it by the X Corporation;

(ii) The Y Corporation takes over the property conveyed to it by the X Corporation subject to a mortgage of $100,000.

(2) Short-term obligations (including notes, drafts, bills of exchange, and bankers' acceptances) having a maturity at the time of issuance of not exceeding 24 months, exclusive of days of grace.

(3) Securities issued or guaranteed as to principal or interest by a government or subdivision thereof (including those issued by a government which is an instrumentality of a government of subdivision thereof).

(4) Stock or securities which are acquired from a registered holding company which acquired such stock or securities after February 28, 1938, as an associate company of a registered holding company which acquired such stock or securities after February 28, 1938, unless such stock or securities were acquired in obedience to an order of the Securities and Exchange Commission (as defined in section 373 (a), as amended) or were acquired with the authorization or approval of the Commission under any section of the Public Utility Holding Company Act of 1935, and are not nonexempt property within the meaning of section 373 (e) (1), (2), or (3).

(5) Money, and the right to receive money not evidenced by a security other than an obligation described as non-exempt property in section 373 (e) (2) or (3). The term "the right to receive money" includes, among other items, accounts receivable, claims for damages, and rights to refunds of taxes.

(f) "Stock or securities." The term "stock or securities" is defined in section 373 (f) for the purposes of sections 371 to 373, inclusive. As therein defined the term includes voting trust certificates and stock rights or warrants.

TAX OF SHAREHOLDERS OF PERSONAL SERVICE CORPORATIONS.

Sec. 301. APPLICABILITY OF SUPPLEMENT S [as added by sec. 602, 2d Rev. Act 1940].

If a personal service corporation (as defined in section 725) is exempt under such section for any taxable year from the excess profits tax imposed by such subchapter, the provisions of this Subchapter shall be applicable with respect to each shareholder of such corporation who was a shareholder in such corporation on the last day of such taxable year and the corporation during the period included in the taxable year, and is not placed on an annual basis under the provisions of section 47 (c).

§ 29.391-1 Applicability of Supplement S. If a personal service corporation (as defined in section 725 and the regulations thereunder) elects not to be subject to the excess profits tax for any taxable year, the term "Supplement S net income" (as defined in section 391 to 396, inclusive) shall be applicable with respect to each person who was a shareholder of such corporation at the close of the taxable year of the corporation. (See section 725 (b).)

Sec. 392. UNDISTRIBUTED S NET INCOME [as added by sec. 602, 2d Rev. Act 1940].

For the purposes of this chapter, the term "undistributed Supplement S net income" means the Supplement S net income (as defined in section 393) minus the amount of the dividends paid, see subsections (d), (e), (f), (g), (h), and (i) of section 27 for the purpose of the basic surtax credit provided in section 27.

§ 29.392-1 Undistributed Supplement S net income. The term "undistributed Supplement S net income" means Supplement S net income (as defined in section 393) minus the amount of dividends paid by the corporation during the taxable year. For the method of computing dividends paid, see subsections (d), (e), (f), (g), (h), and (i) of section 27 and the regulations thereunder.

Sec. 393. Supplement S net income [as added by sec. 602, 2d Rev. Act 1940], and as amended by sec. 323 (b), Rev. Act 1942].

For the purposes of this chapter "Supplement S net income" means the net income, except that there shall be allowed as additional deductions:

(a) The Federal income tax payable under this chapter for the taxable year; and

(b) In lieu of the deduction allowed for the purpose of the basic surtax of the dividends paid during the taxable year, the amount of dividends actually paid, regardless of when pledged and regardless of the method of accounting employed by the corporation in keeping its books and records.

The provisions of the last two paragraphs of § 29.23 (a) to 29.23 (c) relating to (1) the statement in returns of the name and address of each organization to which a contribution or gift was made and the amount and approximate date of the actual payment of the contribution or gift, (2) the substantiation of the claims for deductions when required by the Commissioner, and (3) the basis for calculation of the amount of a contribution or gift which is other than money, are equally applicable to claims for deductions of amounts of contributions or gifts by corporations under section 393.

The method of computing Supplement S net income may be illustrated by the following example:

Example. The X Corporation, a personal service corporation, has for the calendar year 1942 a net income, as computed under chapter 1, of $190,000. The Federal income tax payable under chapter L for that year amounts to $15,000. Contributions or gifts paid, see section 27 (q) for the purposes thereunder, amount to $35,000. The Supplement S net income of the corporation is $124,000, computed as follows:

Net income under chapter 1 $190,000
Add: Contributions deductible in computing net income under section 21 10,000
Less: Federal income tax . . . 645,000
Contributions deductible under section 293 (q) (15 percent of $200,000) . . . . 30,000
76,000
Supplement S net income 124,000

Sec. 394. Corporation income taxed to shareholders [as added by sec. 602, 2d Rev. Act 1940], and as amended by sec. 139 (A), Rev. Act 1942].

(a) General rule. The undistributed Supplement S net income of a personal service corporation shall be included in the gross income of the shareholders in the manner and to the extent set forth in this Supplement.
(b) Amount included in gross income. Each shareholder who, on the last day of the taxable year of the corporation, was a shareholder in such corporation shall include in his gross income, as a dividend, for the taxable year tax-harich or with interest, for the taxable year of the corporation ends, the amount he would have received as a dividend if on such last day there had been distributed to the shareholders, an amount equal to the undistributed Supplement S net income of the corporation for the taxable year.

(c) Credit for obligations of the United States and its instrumentalities. Each such shareholder shall be allowed a credit against his tax liability, made before the expiration of seven years after the date prescribed by law for the filing of his return, for any amount of any adjustment of his gross income from such interest received by the corporation for the taxable year of the corporation beginning after December 31, 1941, any such shareholder's proportionate share of such interest received by the corporation, an amount equal to the undistributed Supplement S net income of the corporation for such taxable year.

(d) Effect on capital account of personal service corporation. An amount equal to the undistributed Supplement S net income of the personal service corporation for its taxable year shall be considered as paid in as of the close of such taxable year as paid-in surplus if any such amount is included in the gross income of the corporation and as a contribution to capital, and the accumulated earnings and profits as of the close of such taxable year shall be correspondingly reduced.

§ 23.394-2 Credit for interest on obligations of the United States and its instrumentalities. Each shareholder of a personal service corporation who as of the close of such taxable year is a shareholder, in cash as a dividend. Such share had been received as a dividend in the return of the shareholder, increased or decreased by any adjustment of such amount in the last determination of the tax liability of the shareholder, an amount equal to the amount that would be required by section 143 (b) or section 144 to be deducted and withheld by the corporation, if any amount required by such Supplement to be included in the gross income of the shareholder, increased or decreased by any adjustment of such amount in the last determination of the tax liability of the shareholder, an amount equal to the amount that would be required by section 143 (b) or section 144 to be deducted and withheld by the corporation.

§ 23.394-3 Effect on capital account of personal service corporation. If the undistributed Supplement S net income of a personal service corporation, or any portion thereof, for any taxable year is required to be included in the gross income of the shareholders, the corporation shall, for the purposes of the tax imposed by section 11 (normal income tax), section 13 (tax on corporations in general), section 14 (tax on special classes of corporations), section 201 (tax on life insurance companies), section 204 (tax on insurance companies other than life or mutual), section 207 (tax on mutual insurance companies other than life), or section 362 (tax on mutual investment companies), be treated as a payment of the specified dividend.

§ 23.394-4 Basis of stock in hands of shareholders. If a shareholder of a personal service corporation is required to include in his gross income his proportionate part of the undistributed Supplement S net income of the corporation, the amount so included shall, for the purpose of adjusting the basis of his stock, be treated as a distribution actually made by the corporation and as a reinvestment in the corporation by the shareholder.

individually, paid in cash to its shareholders as a dividend on the last day of its taxable year.

§ 23.394-1 Taxability of shareholders. If, by reason of an election under section 725, a personal service corporation is exempt from tax, the excess profits tax imposed under chapter E of chapter 2, the undistributed Supplement S net income of the corporation shall be treated as a dividend received by those who, at the close of the taxable year of the corporation, were the shareholders of the corporation and as such would have been entitled to receive such income as a dividend if it had been distributed at that time. Each such shareholder for his taxable year in which or with which the taxable year of

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§ 29.400-1 Scope and application of Supplement T. For the calendar year 1942 and subsequent calendar years, in lieu of the tax imposed under sections 11 and 12, an individual who makes his return on a cash basis may elect to pay the tax imposed under section 400, if his gross income does not exceed $3,000, and if his gross income consists wholly of one or more of the following: Salary, wages, compensation for personal services, dividends, interest, or annuities. For the purposes of the $3,000 limitation, the amount of an individual's gross income shall be determined without subtracting any amount on account of such individual's dependents. For example, a single person who is not the head of a family, has a gross income, consisting of salary, of $3,200 for 1942. He has two dependents. For the purpose of the $3,000 limitation, his gross income is $3,200 ($2,200 minus $1,000), and consequently he may not compute his tax under Supplement T. After the calendar year may file separate returns on Form 1040A, if the gross income of each is from the prescribed sources and does not exceed $3,000, or they may file a single joint return on such form if their combined gross income is from the prescribed sources and does not exceed $6,000. If the husband and wife, together on July 1 of the taxable year may file separate returns on Form 1040A, if the gross income of each is from the prescribed sources and does not exceed $3,000, or they may file a single joint return on such form if their combined gross income is from the prescribed sources and does not exceed $6,000. A married person living with husband or wife at any time during the calendar year may not compute the tax under Supplement T if the other spouse makes an income tax return without regard to such Supplement (see §29.404-1). If an individual deriving any part of the calendar year, his tax may not be determined under Supplement T.

Nor may the tax of the surviving spouse of an individual who has gross income from the disposition of property, may not compute his tax under Supplement T. If an individual derives income from a partnership in which he is a member or from a trust of which he is a beneficiary, and the partnership or trust previously derived the income distributed to him from, for example, interest, he will be considered to have received income from a partnership or trust, rather than from interest, and consequently will not be entitled to compute his tax under Supplement T. A husband and wife, together on July 1 of the taxable year may file separate returns on Form 1040A, if the gross income of each is from the prescribed sources and does not exceed $3,000, or they may file a single joint return on such form if their combined gross income is from the prescribed sources and does not exceed $6,000. A married person living with husband or wife at any time during the calendar year may not compute the tax under Supplement T if the other spouse makes an income tax return without regard to such Supplement (see §29.404-1). If an individual deriving any part of the calendar year, his tax may not be determined under Supplement T.
person making a joint return, or (3) the head of a family, the tax is set forth in the fifth column of the amended schedule. Under the amended schedule no tax is imposed upon a single person whose gross income less credit for dependents does not exceed $525, or upon a married person making a separate return whose gross income less credit for dependents) does not exceed $650, or upon (1) a person who has no gross income, (2) a married person making a separate return, or (3) the head of a family, whose gross income (less credit for dependents) does not exceed $1,050.

Sec. 401. RULES FOR APPLICATION OF SECTION 400 [as added by sec. 102 (a), Rev. Act 1941, and as amended by sec. 104 (b), Rev. Act 1942].

For the purposes of this supplement—

(a) Definitions. (1) "Married person" means a married person living with husband or wife on July 1 of the taxable year.

(2) "Dependent" means a person (other than husband or wife) dependent upon and receiving support from a person on whom the person pays a tax under section 29A04-1 for the taxable year.

(b) Married and not living with husband or wife. A person is considered as a dependent of the head of a family if the person is not living with husband or wife on July 1 of the taxable year and shall be treated as a single person.

§ 29A01-1. Rules for application of schedule in section 400. For the calendar year 1942 and subsequent calendar years, the determination of whether a taxpayer is a single person, a married person, or the head of a family, or whether he has to be made on July 1 of such taxpayer’s taxable year.

Example (1). For the calendar year 1942, A is a married person with a gross income of $3,850 derived wholly from salary and interest. During the month of January, A’s status is that of a head of a family, but on July 1, 1942, his status is that of a single person and of a head of a family. A is a married person making a separate return.

Example (2). For the calendar year 1942, B has a gross income of $2,520, derived wholly from wages and an annuity. On July 1, 1942, they are living together and B is supporting two dependent children, both of whom are under the age of 18. B is not considered as a payment by her husband for the support of any dependent.

Sec. 402. MANNER OF EXACTING [as added by sec. 102 (a), Rev. Act 1941].

The election referred to in section 403 shall be considered to have been made if the taxpayer files the return prescribed for this Supplement and such election shall be irrevocable as to the taxable year. If the taxpayer has filed a return computing his tax without regard to this Supplement, he may not thereby elect for such year to compute his tax under this Supplement.

§ 29A02-1. Manner of election to compute tax under Supplement T. A taxpayer elects to compute his income tax under Supplement T (sections 400 to 404, inclusive) by filing a return of his gross income for the taxable year prescribed for this Supplement. If a husband and wife both make such an election, they may file a joint return reporting their aggregate gross income or they may file separate returns reporting their respective gross incomes. If they file separate returns, the tax of each shall be computed by reference to the fourth column of the schedule set forth in section 400.

An election under Supplement T once made for the taxable year may not be revoked by an individual whose tax status is that of head of a family, but a new election is allowed for each subsequent taxable year. If for any taxable year the taxpayer makes a return with regard to Supplement T, he may not thereafter elect to have his tax computed under such supplement for that subsequent taxable year.

Sec. 403. CREDITS AGAINST TAX NOT ALLOWED [as added by sec. 102 (a), Rev. Act 1941].

Section 31 (relating to credit on tax) and section 32 (relating to credit on taxes withheld at source) shall not apply with respect to such year except as provided in this Supplement.

Sec. 404. CIRCUMSTANCES INELIGIBLE [as added by sec. 102 (a), Rev. Act 1941, and as amended by sec. 104 (b), Rev. Act 1942].

This supplement shall not apply to a nonresident alien individual, to an estate or trust, to an individual filing a return for a period of less than twelve months for any taxable year other than a calendar year, or to a married individual married and living with a dependent or without a dependent whose return is for the taxable year whose spouse files return and computes tax without regard to this supplement.

§ 29A04-1. Taxpayer to whom Supplement T is applicable. The following taxpayers are not entitled to file a return and pay tax under Supplement T:

(a) A nonresident alien individual;

(b) An estate or trust;

(c) An individual who files a return for a period of less than 12 months or for any taxable year other than a calendar year;

(d) An individual who is married and living with husband or wife after August 1 during the calendar year and whose spouse files an income tax return for such year without regard to Supplement T.

ABSTENTION OF TAX FOR MEMBERS OF ARMED FORCES UPON DEATH.

Sec. 411. ABSTENTION OF TAX FOR MEMBERS OF ARMED FORCES UPON DEATH [as added by sec. 8, Current Tax Payment Act 1943].

In the case of any individual who dies on or after January 1, 1941, while in active service as a member of the military or naval forces of the United States or of any of the other United Nations and prior to the termination of the present war as proclaimed by the President, the tax imposed by this chapter shall not apply with respect to the taxable year in which falls the date of his death, and the tax under this chapter and under the corresponding title of each prior revenue law for prior taxable years shall be abated, and if assessed the assessment shall be abated, and if collected shall be credited or refunded as an overpayment.

[Subparts D, E, F, and G will appear in this issue for Friday, November 5, 1943.]

[SEAL] ROBERT E. HANNEGAN,
Commissioner of Internal Revenue.
Approved: October 26, 1943.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.
(c) That any redelegations of authority in effect on the date of this order shall continue in effect subject to any powers heretofore granted to revoke such redelegations and subject further to the limitations in the Department of Agriculture Appropriation Act, 1944, and in this memorandum, with respect to use of funds appropriated and authorized by such act.

(d) That whenever any authority heretofore granted by the Secretary in connection with any program limited the amount of money which might be expended thereunder, such limit shall be deemed applicable to the total amount to be expended under such authorization for such program out of funds appropriated or authorized by prior acts and funds appropriated or advanced pursuant to the Department of Agriculture Appropriation Act, 1944.

(e) The foregoing rules and regulations shall be effective as of July 1, 1943, and remain in effect until my further order.

(Pub. Law No. 129, 78th Cong.; E.O. 9322, 8 F.R. 3807, as amended by E.O. 9334, 8 F.R. 5423)

Issued, this 3d day of November 1943.

MANNIX JONES, War Food Administrator.

Approved: November 3, 1943.

CLAUDE R. WICKHAM, Secretary of Agriculture.

[F.R. Doc. 43-17883; Filed, November 4, 1943; 11:56 a.m.]

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§ 29.451-1 Victory tax on individuals. For taxable years beginning after December 31, 1942, the term "victory tax net income" means the gross income from sources within the United States, plus all amounts received by a nonresident alien subject to the victory tax, the gross income adjusted as indicated in section 451 (a) means only gross income from sources within the United States. As to what constitutes victory tax net income, see § 29.451-1.

(a) Definition. The term "victory tax net income" in the case of any taxable year means (except as provided in subsection (c)) the gross income for such year (not including gain from the sale or exchange of capital assets as defined in section 117) or interest allowed as a credit against net income under section 25 (1) and (2), or amounts received as compensation for injury or sickness which are included in gross income for the purpose of the computation of net income of participants in a common trust fund computed as provided in section 169 (b). The term "victory tax net income" means the gross income for each taxable year beginning after December 31, 1942, a victory tax of 5 per cent upon the victory tax net income of every individual (other than a nonresident alien subject to the tax imposed by section 211 (a)).

(b) Basis. The basis for determining the amount of deduction for losses sustained, to be allowed under paragraph (a) of this subsection, is the adjusted basis for capital assets as defined in section 22 (1) for taxable years beginning after December 31, 1942, and before the day following the date of cessation of hostilities in the present war. The term "victory tax net income" means the gross income for each taxable year beginning after December 31, 1942, the deductions allowable by subsection (a) shall be subject to the limitations contained in section 22 (b). The term "victory tax net income" means the gross income for each taxable year beginning after December 31, 1942, the amount allowable by subsection (a) of section 162 in addition to the amounts allowable by subsections (b) and (c) of such section.

(c) Rule applicable to participants in a common trust fund. In the case of a participant in a common trust fund, he shall in respect of the common trust fund income included in gross income for purposes of the victory tax, the gross income adjusted as indicated in section 451 (a) means only gross income from sources within the United States. As to what constitutes victory tax net income, see § 29.451-1.

§ 29.451-2 Victory tax net income—

(a) Citizen or resident of the United States. The term "victory tax net income" in the case of a citizen or resident of the United States, whether engaged in a trade or business within the United States or not, means gross income as defined in section 61, adjusted as described in § 29.451-1 (a), less the deductions provided in the case of individuals under section 22 relating to the provisions from gross income, subject, however, to the qualifications, limitations, and exceptions with respect to such deductions provided in section 451 and this section. The deductions, therefore, from gross income (as defined in § 23.451-1 (a) (allowable for the purpose of the computation of net income of participants in a common trust fund, computed as provided in section 169 (b). As to the meaning of the term "victory tax net income," see § 29.451-1.)
poses of the determination of victory tax net income are those set forth in section 23 and the regulations thereunder, subject, however, to the following qualifications, limitations, and exceptions:

(1) Interest. The deduction generally allowable for interest under the provisions of section 23 (b) is allowable for the purposes of the victory tax if, and only if, the indebtedness with respect to which such interest is allowed was incurred:

(i) In carrying on any trade or business;

(ii) For the production or collection of income; or

(iii) For the management, conservation, or maintenance of property held for the production of income.

Hence, for example, interest upon indebtedness representing a mortgage upon the home of the taxpayer is not deductible for the purposes of the victory tax. Interest upon indebtedness incurred incident to the acquisition of property held for investment, even though it actually produces no income during the taxable year, is nevertheless deductible. For the treatment of interest as a deduction from gross income generally, see section 23 (b) and the regulations thereunder.

(2) Taxes. The deduction generally allowable for taxes paid or incurred under the provisions of section 23 (c) is allowable for the purposes of the victory tax if, and only if, paid or incurred:

(i) In connection with the carrying on of a trade or business;

(ii) In connection with property used in the trade or business; or

(iii) In connection with property held for the production of income.

Hence, for example, taxes paid by the taxpayer with respect to ownership of his home are not deductible for this purpose. Likewise, automobile license fees are not deductible. Gross income tax payable except in the case of automobiles used in connection with the carrying on of a trade or business. Taxes are not deductible which are paid or incurred by reason of ownership of property held by the taxpayer primarily as a sport, hobby, or recreation. The deduction for retail sales taxes provided in section 23 (c) (3) is not applicable for victory tax purposes. Income, war profits, or excess profits taxes paid to a foreign country or to a possession of the United States are not deductible if the taxpayer chooses to take for any ownership of property held by the taxpayer primarily as a sport, hobby, or recreation. The deduction for retail sales taxes provided in connection with the carrying on of a trade or business. Taxes are not deductible which are paid or incurred by reason of ownership of property held by the taxpayer primarily as a sport, hobby, or recreation. The deduction for retail sales taxes provided in section 23 (c) is not allowable for the determination of the victory tax net income except, however, that in the case of any individual who qualifies under the provisions of section 120, the deduction is allowable to the extent permitted by section 23 (k) (2). For treatment of bad debts generally, see section 23 (k) and the regulations thereunder.

(5) Contributions. The deduction for charitable and other contributions allowed generally under the provisions of section 23 (o) is not allowable for the determination of the victory tax net income except, however, that in the case of any individual who qualifies under the provisions of section 120, the deduction is allowable to the extent permitted by section 23 (o) without regard to the percentage limitation contained therein. See § 29.120–1. In the case of estates or trusts, however, the deductions provided in section 23 (o) are not allowable for the determination of victory tax net income as defined in section 23 (c) (3) and allowable for income tax purposes to the extent permitted by section 23 (k) (2). For treatment of bad debts generally, see section 23 (k) and the regulations thereunder.

(7) Items not deductible generally. In addition to the deductions generally allowable under chapter 1 but disallowed for the purposes of the victory tax net income as set forth in subparagraphs (1) to (6), inclusive, there are also disallowed for the purposes of the determination of the victory tax net income those amounts disallowed generally under the provisions of section 24. See §§ 29.24–1 to 29.24–7, inclusive.

(b) Nonresident aliens. In addition to the qualifications, limitations, and exceptions contained in subparagraphs (1) to (7), inclusive, of paragraph (a) of this section, the general rules with respect to deductions for the purposes of the victory tax net income apply to nonresident aliens in the same manner as provided in section 251. The deduction generally allowable for victory tax purposes only, against the victory tax. Such deductions are allowable only if and to the extent that they are connected with income from sources within the United States. See section 213 and § 29.213–1.

(c) United States citizen entitled to benefits of section 251. In addition to the qualifications, limitations, and exceptions contained in paragraphs (a) (1) to (a) (7), inclusive, of this section, the general rules with respect to deductions for the purposes of the victory tax net income are those set forth in section 251 (a) (2), even though no credit is allowed for such taxes to the credit for foreign taxes even within the United States. See § 29.251–5.

(d) Supplement T taxpayer. If for any taxable year an individual citizen of the United States makes his return and pays his tax under Supplement T (sections 400 to 404, inclusive), relating to individuals entitled to file a return therefor, there are also disallowed for the purposes of the victory tax net income means gross income for such year and the provisions of section 451 and of this section relating to contributions are allowable generally under the provisions of section 23 (o), and the regulations thereunder.

§ 29.452–1 Specific exemption. For the purposes of computing the victory tax, there is allowed against the victory tax net income but one credit, namely, a specific exemption of $624. In the case of a husband and wife making a joint return under section 25 (b) (1), if the victory tax net income of one spouse is less than $624, the aggregate specific exemption of both spouses shall be limited to $624 plus the victory tax net income of such spouse.
spouses amounts to $824 plus the victory tax net income of such spouse. Thus, if A and his wife and B each have a joint return for the year 1943 and B has victory tax net income of $300, the total specific exemption for both spouses in such case is $824. In any such case in which the sum of the victory tax net income of more than $304 is claimed, the facts with respect to the victory tax net income of the respective spouses shall be set forth in an appropriate manner in the taxpayer's return. The principles applicable for the determination of net income of the respective spouses, subject, however, to the qualifications, limitations, and exceptions provided in section 451. See section 22 and the regulations thereunder.

Sec. 453. Credit against victory tax [as added by sec. 172 (a), Rev. Act. 1942].

(a) Allotment of credit. There shall be allowed as a credit against the victory tax for each taxable year:

(1) The amount paid by the taxpayer during the taxable year as premiums on life insurance policies owned by the taxpayer on the last day of the taxable year, as follows:

(A) The amount paid during the taxable year as premiums on life insurance which is a renewal or conversion of such life insurance in force on September 1, 1942, to the extent that such premiums do not exceed the amount payable on such life insurance in force on September 1, 1942.

(B) The amount by which the smallest amount of indebtedness of the taxpayer outstanding at the close of the preceding taxable year, exceeds the amount of indebtedness of the taxpayer outstanding at the close of the taxable year.

(C) The amount by which the amount of obligations of the United States owned by the taxpayer on the last day of the taxable year exceeds the greater of (A) the amount of such obligations owned by the taxpayer as of the close of the last day of any preceding taxable year ending on or before December 31, 1942, or (B) the highest amount of such obligations owned by the taxpayer on the last day of any preceding taxable year ending on or before September 1, 1942.

(2) The amount of the post war credit or refund which may be applied as a credit against the victory tax for the taxable year by reason of payment of insurance premiums is the amount paid by the taxpayer during the taxable year as premiums upon such life insurance. If any such life insurance so in force on September 1, 1942, is renewed or converted after such date, the credit for premiums paid with respect to such renewed or converted life insurance can not in any event exceed the amount of such obligations owned by the taxpayer as of the close of the taxable year over whichever of the following amounts is the greater:

(i) The amount of such obligations owned by the taxpayer as of the close of the calendar year 1942, or (ii) the largest amount of such obligations owned by the taxpayer as of the close of the last day of the taxable year ending after December 31, 1942.

As used in section 453 (a) (3), the term "post war credit or refund" includes only such obligations as have been evidenced by the taxpayer by purchase and does not include obligations acquired by gift or inheritance. Obligations acquired by purchase or mortgage prior to the adoption of section 453 by the taxpayer under such circumstances that their acquisition results in the recognition of income to him. For purposes of the victory tax credit, if an obligation is registered in the names of two persons as co-owners, each shall, in the absence of evidence to the contrary, be presumed to be a purchaser and shall be entitled to the credit to the extent of one half of the face value of the obligation. In such case, the entire purchase price is contributed by one co-owner, he may, if he so elects at the time of filing his first return under the victory tax subsequent to the purchase of the obligation, be considered to be sole owner, in which case he shall be entitled to a credit to the full extent of the purchase price and no credit shall be allowed to the other co-owner. For the purposes of section 453 (a) (3), a United States obligation held in the names of the following items but in an amount not in excess in any event of the post war credit or refund allowed by section 454 for such taxable year:

(i) Premiums paid by the taxpayer on life insurance;

(ii) Reduction in indebtedness of the taxpayer;

(iii) Increase in taxpayer's holdings of certain United States obligations.

The credit provided in section 453 does not reduce the amount of the victory tax to be withheld at the source as provided in section 456. Such credit is applied against the amount of the victory tax as shown by the taxpayer's victory tax return. The taxpayer is not required to avail himself of such credit. In such event he will be entitled to the post war credit or refund with respect to such taxable year provided in section 454.

(b) Special items of the credit.—(1) Premiums paid by taxpayer on life insurance.

The amount paid by the taxpayer during the taxable year as premiums on life insurance policies owned by the taxpayer on the last day of such taxable year, as follows:

(A) As provided in section 453 (a) (2) (C). In computing the amount of the credit under section 453 (a) (1), no account is to be taken of any life insurance policy in force on September 1, 1942.

(B) The amount of any life insurance policy in force on September 1, 1942, to the extent of dividends received during such taxable year.

(C) The amount of the post war credit or refund which may be applied as a credit against the victory tax for the taxable year by reason of payment of insurance premiums is the amount paid by the taxpayer during the taxable year as premiums upon such life insurance. If any such life insurance so in force on September 1, 1942, is renewed or converted after such date, the credit for premiums paid with respect to such renewed or converted life insurance can not in any event exceed the amount of such obligations owned by the taxpayer as of the close of the calendar year 1942, or (ii) the largest amount of such obligations owned by the taxpayer as of the close of the last day of the taxable year ending after December 31, 1942.

As used in section 453 (a) (3), the term "post war credit or refund" includes only such obligations as have been evidenced by the taxpayer by purchase and does not include obligations acquired by gift or inheritance. Obligations acquired by purchase or mortgage prior to the adoption of section 453 by the taxpayer under such circumstances that their acquisition results in the recognition of income to him. For purposes of the victory tax credit, if an obligation is registered in the names of two persons as co-owners, each shall, in the absence of evidence to the contrary, be presumed to be a purchaser and shall be entitled to the credit to the extent of one half of the face value of the obligation. In such case, the entire purchase price is contributed by one co-owner, he may, if he so elects at the time of filing his first return under the victory tax subsequent to the purchase of the obligation, be considered to be sole owner, in which case he shall be entitled to a credit to the full extent of the purchase price and no credit shall be allowed to the other co-owner. For the purposes of section 453 (a) (3), a United States obligation held in the names of the following items but in an amount not in excess in any event of the post war credit or refund allowed by section 454 for such taxable year:

(i) Premiums paid by the taxpayer on life insurance;

(ii) Reduction in indebtedness of the taxpayer;

(iii) Increase in taxpayer's holdings of certain United States obligations.

The credit provided in section 453 does not reduce the amount of the victory tax to be withheld at the source as provided in section 456. Such credit is applied against the amount of the victory tax as shown by the taxpayer's victory tax return. The taxpayer is not required to avail himself of such credit. In such event he will be entitled to the post war credit or refund with respect to such taxable year provided in section 454.

Example. A had outstanding as of September 1, 1942, a mortgage upon his home in the amount of $5,000 which had been reduced to $4,500 as of December 31, 1942, and to $4,250 on December 31, 1943. In such case the potential credit against the victory tax by reason of reduction of indebtedness is $4,500 minus $4,250, or $250. The amount is subject to the limitation that it can not in any event exceed the amount of post war credit or refund provided in section 454.

(3) Increase in holdings of United States obligations. The amount of the post war credit or refund available to the taxpayer as a credit against the victory tax for the taxable year by reason of increase in his holdings of obligations of United States is measured by the excess of the amount of such obligations owned by the taxpayer as of the close of the last day of the taxable year over whichever of the following amounts is the greater:

(i) The amount of such obligations owned by the taxpayer as of the close of the calendar year 1942, or (ii) the largest amount of such obligations owned by the taxpayer as of the close of the last day of any preceding taxable year ending after December 31, 1942.

As used in section 453 (a) (3), the term "increase in holdings of United States obligations" includes only such obligations as have been evidenced by the taxpayer by purchase and does not include obligations acquired by gift or inheritance. Obligations acquired by purchase or mortgage prior to the adoption of section 453 by the taxpayer under such circumstances that their acquisition results in the recognition of income to him. For purposes of the victory tax credit, if an obligation is registered in the names of two persons as co-owners, each shall, in the absence of evidence to the contrary, be presumed to be a purchaser and shall be entitled to the credit to the extent of one half of the face value of the obligation. In such case, the entire purchase price is contributed by one co-owner, he may, if he so elects at the time of filing his first return under the victory tax subsequent to the purchase of the obligation, be considered to be sole owner, in which case he shall be entitled to a credit to the full extent of the purchase price and no credit shall be allowed to the other co-owner. For the purposes of section 453 (a) (3), a United States obligation held in the names of the following items but in an amount not in excess in any event of the post war credit or refund allowed by section 454 for such taxable year:

(i) Premiums paid by the taxpayer on life insurance;

(ii) Reduction in indebtedness of the taxpayer;

(iii) Increase in taxpayer's holdings of certain United States obligations.

The credit provided in section 453 does not reduce the amount of the victory tax to be withheld at the source as provided in section 456. Such credit is applied against the amount of the victory tax as shown by the taxpayer's victory tax return. The taxpayer is not required to avail himself of such credit. In such event he will be entitled to the post war credit or refund with respect to such taxable year provided in section 454.

Example. A had outstanding as of September 1, 1942, a mortgage upon his home in the amount of $5,000 which had been reduced to $4,500 as of December 31, 1942, and to $4,250 on December 31, 1943. In such case the potential credit against the victory tax by reason of reduction of indebtedness is $4,500 minus $4,250, or $250. The amount is subject to the limitation that it can not in any event exceed the amount of post war credit or refund provided in section 454.
tions of the United States' for the purpose of the credit means only United States savings bonds, Series E, F, and G, which are purchased in such manner and under such terms and conditions as the Secretary may by regulations prescribe, subject, however, to the right of the Secretary at any time to restrict, amplify, or extend the class or classes of United States obligations with respect to which the taxpayer may be entitled to a credit under the provisions of section 453 (or any other section of this title) or under any other terms, and conditions under which obligations may be purchased. See Treasury Department Circular No. 704, approved December 29, 1943. The term "amount of obligations" as used in section 453 (a) (3) means the amount paid for the obligations and not the par value thereof and does not include the interest, if any, accrued thereon.

The application of section 453 (a) (3) may be illustrated by the following example:

Example. A and his wife file a joint return for the year 1943. On December 31, 1942, A owned a United States savings bond, Series E, of a par value of $500 for which he and his wife had previously paid the amount of $375, the bond being registered in the name of A or his wife B. During 1943 A and B purchased additional bonds of a par value of $500 of the same series of United States savings bonds for which they paid $150, such bonds being registered in the same manner provided for by law. They also acquired by inheritance a similar bond in the denomination of $1,000. The three bonds were held as of the close of the calendar year 1945. Since the $1,000 bond had been acquired by inheritance, such obligation has no effect upon the credit against the victory tax. Since A and B file a joint return, they are entitled to a credit under section 453 (a) (3) of $150, the difference between the amount of the bonds as of December 31, 1942, and $375 (the amount owned as of December 31, 1942), subject to the limitation that such credit can not in any event exceed the amount of the post war credit or refund allowed by section 454. If A and B file separate returns, each would be entitled to a credit under section 453 (a) (3) in the amount of $75.

For the application as a credit against the victory tax (adjusted for the credit allowed by section 453) of the tax withheld at the source under section 466, see § 29.458-5.

Sec. 454. Post war credit or refund of victory tax [as added by sec. 172. (a), Rev. Act 1942].

(a) Allowance of credit. As soon as practicable after date of cessation of hostilities in the present war (as defined in section 475 (b)), the following amount of the victory tax paid for certain beginning calendar years ending December 31, 1942, shall be credited against any income tax or installment thereof due from the taxpayer, and any balance shall be refunded immediately to the taxpayer:

(1) In the case of a single person or a married person living with his wife, 25 per centum of the victory tax or $500, whichever is the lesser.

(2) In the case of a head of a family, 40 per centum of the victory tax or $800, whichever is the lesser. In the case of a married person living with husband or wife, 25 per centum of the victory tax or $500, whichever is the lesser. In the case of a married person living with husband or wife where a separate return is filed by one spouse and no return is filed by the other spouse, or in the case of a husband and wife filing a joint return under section 81 (b), only one credit shall be allowed and such credit shall not exceed 40 per centum of the victory tax or $1,000, whichever is the lesser.

(3) For each dependant specified in section 28 (b), excluding as a dependent, in the case of a married person living with husband or wife, any person claiming the status of dependant by virtue of the provisions of section 401.

(b) Limitations on amount of post war credit or refund. The post war credit or refund provided in section 454 is subject to the following limitations:

(1) Single person or married person not living with husband or wife. 25 per centum of the amount of the victory tax, or $500, whichever is the lesser.

(2) Married person living with husband or wife where separate returns are filed by each spouse. 40 per centum of the victory tax, or $800, whichever is the lesser.

(c) Limitation of credit or refund provided in section 454. In the case of a married person living with husband or wife, 25 per centum of the amount of the victory tax, or $1,000, whichever is the lesser.

(d) Limitation of credit or refund provided in section 454. The post war credit or refund provided in section 454 is subject to the following limitations:

(1) Married person living with husband or wife. 25 per centum of the amount of the victory tax, or $1,000, whichever is the lesser.

(e) Married person living with husband or wife where separate returns are filed. 40 per centum of the amount of the victory tax, or $800, whichever is the lesser.

(f) Married person living with husband or wife where separate returns are filed. 25 per centum of the amount of the victory tax, or $500, whichever is the lesser.

Sec. 455. Post war credit or refund of victory tax (as added by sec. 172. (a), Rev. Act 1942).

(a) General. Section 455 provides that, as soon as practicable after the cessation of hostilities in the present war (as defined in section 475 (b)), there shall be allowed as a credit against the income tax of the taxpayer certain designated amounts representing portions of the victory tax paid for taxable years beginning after December 31, 1942, but not in excess of certain percentages of the amount of the victory tax paid for taxable years beginning before December 31, 1942, during the period for which the credit is allowed. Such post war credit or refund provided in this section shall be reduced by the amount of any credit allowed under section 453.

§ 29.454–1 Post war credit or refund—

(a) General. Section 454 provides that, as soon as practicable after the cessation of hostilities in the present war (as defined in section 475 (b)), there shall be allowed as a credit against the income tax of the taxpayer certain designated amounts representing portions of the victory tax paid for taxable years beginning after December 31, 1942, but not in excess of certain percentages of the amount of the victory tax, such percentages being conditioned upon the marital status of the taxpayer and the number of his dependants during the year or years for which such credit is claimed. Such post war credit or refund provided in this section shall be reduced by the amount of any credit allowed under section 453 (or any other section). The following regulations are prescribed:

(1) For 1943 a husband and wife with two dependents file a joint return and have a victory tax net income (after specified deduction) of $600, whichever is the lesser.

(2) Married person living with husband or wife where separate returns are filed. 40 per centum of the amount of the victory tax, or $800, whichever is the lesser.

(3) Married person living with husband or wife where separate returns are filed. 25 per centum of the amount of the victory tax, or $500, whichever is the lesser.

(4) Married person living with husband or wife where separate returns are filed. 25 per centum of the amount of the victory tax, or $1,000, whichever is the lesser.

(5) Married person living with husband or wife where separate returns are filed. 40 per centum of the amount of the victory tax, or $800, whichever is the lesser.

(6) Married person living with husband or wife where separate returns are filed. 25 per centum of the amount of the victory tax, or $1,000, whichever is the lesser.

(7) Married person living with husband or wife where separate returns are filed. 40 per centum of the amount of the victory tax, or $800, whichever is the lesser.

(8) Married person living with husband or wife where separate returns are filed. 25 per centum of the amount of the victory tax, or $1,000, whichever is the lesser.

(9) Married person living with husband or wife where separate returns are filed. 40 per centum of the amount of the victory tax, or $800, whichever is the lesser.

(10) Married person living with husband or wife where separate returns are filed. 25 per centum of the amount of the victory tax, or $1,000, whichever is the lesser.

(11) Married person living with husband or wife where separate returns are filed. 40 per centum of the amount of the victory tax, or $800, whichever is the lesser.

(12) Married person living with husband or wife where separate returns are filed. 25 per centum of the amount of the victory tax, or $1,000, whichever is the lesser.

(13) Married person living with husband or wife where separate returns are filed. 40 per centum of the amount of the victory tax, or $800, whichever is the lesser.

(14) Married person living with husband or wife where separate returns are filed. 25 per centum of the amount of the victory tax, or $1,000, whichever is the lesser.

(15) Married person living with husband or wife where separate returns are filed. 40 per centum of the amount of the victory tax, or $800, whichever is the lesser.

(16) Married person living with husband or wife where separate returns are filed. 25 per centum of the amount of the victory tax, or $1,000, whichever is the lesser.

(17) Married person living with husband or wife where separate returns are filed. 40 per centum of the amount of the victory tax, or $800, whichever is the lesser.

(18) Married person living with husband or wife where separate returns are filed. 25 per centum of the amount of the victory tax, or $1,000, whichever is the lesser.

(19) Married person living with husband or wife where separate returns are filed. 40 per centum of the amount of the victory tax, or $800, whichever is the lesser.

(20) Married person living with husband or wife where separate returns are filed. 25 per centum of the amount of the victory tax, or $1,000, whichever is the lesser.
Victory tax (5 percent of $60,000) $3,000
Post war refund: 4 percent of victory tax $1,200
or $1,000 plus $200 1,200
whichever is the lesser 1,200

Example (3). For 1943 a husband and wife (who both dependents supported by the husband) file separate returns. The husband has a victory tax net income (after specific exemption) of $60,000 and the wife has a victory tax net income (after specific exemption) of $20,000.

Computation for husband:

Victory tax (5 percent of $60,000) $3,000
Limitation: 40 percent of victory tax $1,200
or $500 plus $200 $700
whichever is the lesser $700

Computation for wife:

Victory tax (5 percent of $20,000) $1,000
Limitation: 40 percent of victory tax $400
or $500 plus $200 $700
whichever is the lesser $700

Recapitulation:
Credit or refund of husband $700
Credit or refund of wife $700

In the application of section 454 (a) to a nonresident alien subject to the victory tax, the provisions of section 214, relating to exemption and credits in the case of such taxpayer, shall be applicable and hence the additional credit for dependents provided in section 454 (a) (3) is allowed only if such taxpayer is a resident of a contiguous country.

§ 29.454-2 Post war credit or refund where status changes during the taxable year—(a) General. If the status of the taxpayer (other than a taxpayer who makes his return and pays his tax under Supplement T) with respect to his marital relationship or with respect to his dependents changes during the taxable year, the amounts of the post war credit or refund under section 454 and § 29.454-1 shall be apportioned according to the number of months during which the taxpayer occupied each status. For the purposes of the apportionment, a fractional part of a month shall be disregarded unless it amounts to more than one-half of a month in which case it shall be considered as a month. In general, the post war credit or refund in the case of any taxpayer whose status as set forth above changed during the taxable year will be the sum of the amounts apportioned to the respective periods during which each status was occupied. If married persons file a joint return for a taxable year in which a change in the marital status has occurred, then, for the purpose of computing the credit or refund applicable to that portion of such taxable year preceding the change of status, one-half of the joint victory tax shall be attributed to each spouse. These principles may be illustrated by the following examples:

Example (1). A and B were married on August 10, 1943, each having the status of a single person prior to such date. They have no dependents. They had a combined victory tax net income (before the specific exemption) of $25,248. The victory tax net income of each is in excess of $254. They file a joint return for 1943. The post war credit or refund in each case is computed as follows:

Victory tax for 1943 on basis of joint return (10 percent of $25,248 (2458 minutes of $24,248)) $1,200

Post war credit or refund:

A.
1. Limitation on post war credit or refund (12 × (25 percent of $25,248)) $2,430
2. Post war credit or refund equals (The figure of $2,530 applies since it is less than $2,430) $1,200
B.
1. Limitation on post war credit or refund (112 × (25 percent of $25,248)) $2,430
2. Post war credit or refund equals (The figure of $2,530 applies since it is less than $2,430) $1,200

Example (2). A, a widower having two dependent children under 18 years of age, married B on July 1, 1943. They filed a joint return for the calendar year 1943 showing victory tax net income of $61,248 (before the application of the specific exemption) and a victory tax of $3,000. The victory tax net income of each exceeded the specific exemption of $254. The post war credit or refund in each case is computed as follows:

First half of year

A. Limitation on post war credit or refund (5 × (42 percent of $1,000) or $2,500) $1,000

Post war credit or refund $1,000

B. Limitation on post war credit or refund (5 × (42 percent of $1,000) or $2,500) $1,000

Post war credit or refund $1,000

Recapitulation—Post war credit or refund

Apportioned to A 500.00
Apportioned to B 500.00
Apportioned to A and B jointly 1,000.00

Total for A and B 1,000.00

Payments made by the husband to the wife of an amount which is includable in her gross income by reason of section 31 and section 72, shall be considered as payment by the husband for the support of any dependent.

§ 29.454-3 Period of limitation for making post war credit or refund. The post war credit or refund provided in section 454, to the extent such credit or refund is not applied under section 453 as a credit against the victory tax, cannot be made after seven years from the date of cessation of hostilities in the present war (as that term is defined in section 475 (b)) unless claim for credit or refund thereof is filed with the collector of internal revenue before the expiration of such 7-year period. No interest is allowable upon such credits or refunds of the victory tax. For the manner of filing claims for refund or credit generally, see § 29.322-3.

Soc. 455. Rulings [as added by sec. 172 (c), Rev. Act 1942].
(a) Individual returns. Every individual having a gross income in excess of $625 for the taxable year, shall make, under regulations prescribed by the Commissioner, with the return prescribed for the taxable year, a declaration that it is made under the pen-
or the spouses may elect to make a joint return. See section 51 (b), shall be appli-
cable year and the other spouse has less gross income. Hence, if a husband and wife living together may not elect to make separate returns for the purpose of the tax imposed by sections 11 and 12 or Supplement T and a joint return is required to be made under this subsection.

§ 29.455-1 Returns—(a) Individuals. For taxable years beginning after December 31, 1942, shall make a joint fiduciary returns. Every fiduciary (except a receiver appointed by authority of law in possession of the property of an individual) shall make, under regulations prescribed by the Commissioner with the approval of the Secretary, a return for victory tax purposes, a return for normal tax and surtax purposes shall be made a part of such return.

The status of a taxpayer making his return and paying his tax under Supplement T is determined under the provisions of section 491. Under those provisions, a return for victory tax purposes, a return for normal tax and surtax purposes shall be made a part of such return. The return for victory tax purposes shall be a part of the return for normal tax and surtax purposes, a return for victory tax purposes shall be made a part of such return. The return for victory tax purposes shall be made a part of the return for the purpose of the victory tax and joint returns for the purpose of the other parts of the tax imposed.

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while outside the United States (as defined in section 2979 (a) (9)), unless the major part of the services performed during the calendar week in which the employee earns the wages is performed within the United States.

(c) Withholding agent. The term “withholding agent” means any person required to withhold, collect, and pay the tax under section 6201.

(d) Employee. The term “employee” includes an officer, employee, or elected official of the United States, a State, Territory, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing, or an individual performing any service, of whatever nature, for the employee for his employer, or the employee’s corporation.

(e) Employer. The term “employer” includes any person for whom an individual performs any service, of whatever nature, for the employee of such person.

§ 29.465-0 Introductory. Sections 465 to 470, inclusive, provide for collection of tax at the source on wages. The regulations prescribed thereunder relate to the operation and effect of the provisions dealing with collection at the source and have no application in the determination of questions relating to the incidence or operation and effect of the provisions.-1. § 29.465-1 Pay-roll period. The term “pay-roll period” means the period for which a payment of wages is ordinarily made to an employee by his employer. If the periods for which payments of wages are made to an employee by his employer are of uniform duration, each such period constitutes a pay-roll period. If, however, the periods occasioning payment of wages to an employee are of uniform duration, each such period constitutes a pay-roll period. If, however, the periods occasioning payment of wages to an employee are of uniform duration, each such period constitutes a pay-roll period.

Example. A is employed by B during the month of January 1943 and is entitled to receive remuneration of $100 for the services performed for B during the month. A leaves the employ of B at the close of business on January 31, 1943. On February 15, 1943, the employer (A) makes a pay-roll to A of $150 which is earned for the services rendered by A to B during the month of January. A is entitled to receive remuneration of $100 for services rendered in January, and $50 for services rendered in February. A is not entitled to receive remuneration of $50 for services rendered in January, even though the employee has earned such amount of wages, because the pay-roll period is calendar month.

§ 29.465-2 Wages.—(a) In general. The term “wages” means all remunerations for services performed by an employee and not excluded under section 465 (b) or section 466 (g). (See §§ 29.465-3 and 29.465-6.)

The name by which the remuneration for services is designated is immaterial. Thus, salaries, fees, bonuses, commissions on sales or on insurance premiums, pensions, and retired pay are wages within the meaning of the statute if paid as compensation for services performed by the employee for his employer.

The basis upon which the remuneration is paid is immaterial in determining whether the remuneration constitutes wages. Thus it may be paid on the basis of piecework, or as a percentage of profits; and may be paid hourly, daily, weekly, monthly, or annually.

The medium in which the remuneration is paid is also immaterial. It may be paid in cash or in any other than cash, as, for example, stocks, bonds, or other forms of property. Remuneration paid in items other than cash shall be computed on the basis of the fair market value of such items at the time of payment.

Ordinarily, facilities or privileges such as entertainment, medical services, or so-called “courtesy” discounts on purchases made by an employee to his employees generally, are not considered as remuneration for services. If such facilities or privileges are of relatively small value and are offered or furnished by the employer primarily as a means of promoting the health, good will, contentment, or efficiency of his employees.

Tips or gratuities paid directly to an employee by a customer of an employer, and not accounted for by the employee to the employer, are not subject to withholding.

Remuneration for services, unless such remuneration is specifically excluded by the statute, constitutes wages even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them.

Example. A is employed by B during the month of January 1943 and is entitled to receive remuneration of $100 for the services performed for B during the month. A leaves the employ of B at the close of business on January 31, 1943. On February 15, 1943, the employer (A) makes a pay-roll to A of $150 which is earned for the services performed in January. The $150 is wages within the meaning of the statute.

(b) Pensions and retired pay. Pensions and retired pay are wages within the meaning of the statute. However, amounts receivable by an employee upon retirement which are taxed as annuities under section 745 are not included within the definition of the term “wages.” Residences granted to employees by an employer for services performed as a member of the military or naval forces of the United States are not included within the definition of the term “wages.” For the purpose of the exception, the military and naval forces of the United States include but are not necessarily limited to the Army, the Navy, the Marine Corps, the Coast Guard, the Army Nurse Corps, the Navy Nurse Corps, the Women’s Army Corps, and the Women’s Reserve Branch of the Coast Guard Reserve, and the Marine Corps Women’s Reserve.

(c) Remuneration paid for agricultural labor.—(1) In general. The term “wages” does not include remuneration for services which constitute agricul-
tural labor as defined in section 1426 (h) of the Internal Revenue Code. The term "agricultural labor" as so defined includes services of a character described in subparagraphs (2), (3), (4), and (5) of this paragraph.

In general, however, the term "agricultural labor" does not include services performed in connection with forestry, lumbering, or landscaping.

(2) Services described in section 1426 (h) (1). Remuneration paid for services performed on a farm by an employee of any person in connection with any of the following activities is excepted as remuneration for agricultural labor:

(i) The cultivation of the soil;
(ii) The raising, bearing, feeding, caring for, training, or management of live stock, bees, poultry, fur-bearing animals, or wildlife; or
(iii) The raising or harvesting of any other agricultural or horticultural commodity.

The term "farm" as used in this and succeeding paragraphs of this subsection includes stock, dairy, poultry, fruit, fur-bearing animals, orchards, and such greenhouses and other similar structures as are used primarily for the raising of agricultural or horticultural commodities. Greenhouses and other similar structures used primarily for other purposes (for example, display, storage, and fabrication of wares, household and bouquets), do not constitute "farms."

(3) Services described in section 1426 (h) (2). The remuneration paid for the following services performed by an employee in the employ of the owner or tenant or other operator of one or more farms is excepted as remuneration for agricultural labor, provided the major part of such services is performed on a farm:

(i) Services performed in connection with the operation, management, conservation, improvement, or maintenance of any or all of such farms or its tools or equipment; or
(ii) Services performed in salving timber, or clearing land of brush and other debris, left by a hurricane.

The services described in (i) above may include, for example, services performed by carpenters, painters, mechanics, farm supervisors, irrigation engineers, bookkeepers, and other skilled or semiskilled workers, which contribute in any way to the conduct of the farm or farms, as such, operated by the person employing them, as distinguished from any other enterprises in which such persons, or substantially the same persons, are engaged.

Since the services described in this subparagraph (3) must be performed in the employ of the owner or tenant or other operator of the farm, the exception does not extend to remuneration paid for services performed by employees of a commercial painting concern, for example, which contracts with a farmer to renovate his farm properties.

(4) Services described in section 1426 (h) (3). Remuneration paid for services performed by an employee in the employ of any person in connection with any of the following is excepted as remuneration for agricultural labor without regard to the place where such services are performed:

(i) The ginning of cotton;
(ii) The hatching of poultry;
(iii) The raising or harvesting of mushrooms;
(iv) The operation or maintenance of ditches, canals, reservoirs, or waterways used exclusively for supplying or storing water for farming purposes;
(v) The production or harvesting of maple sap, maple syrup, maple sugar (but not the subsequent blending or other processing of such syrup or sugar with other products); or
(vi) Services performed on a farm by an employee of a farmer or farmers' cooperative or a commercial handler of such commodities.

(ii) Remuneration paid for services performed by an employee in the employ of a farmer or farmers' cooperative organization or group in the handling, planting, drying, packing, processing, freezing, grading, storing, or delivering to storage or market or to a carrier for transportation to market, of any agricultural or horticultural commodity, other than fruits and vegetables (see subdivision (v) below), produced by such farmer or members of such organization or group of farmers is excepted, provided such services are performed as an incident to ordinary farming operations.

Generally, services are performed "as an incident to ordinary farming operations" within the meaning of this subparagraph (5) if they are services of the character ordinarily performed by the employees of a farmer or farmers' cooperative organization or group as a prerequisite to the marketing, in its unmanufactured state, of any agricultural or horticultural commodity produced by such farmer or by members of such organization or group. Services performed by employees of such farmer or farmers' organization or group in the handling, planting, drying, packing, processing, freezing, grading, storing, or delivering to storage or to market or to a carrier for transportation to market, of any agricultural or horticultural commodity produced by persons other than such farmer or members of such organization or group are not performed "as an incident to ordinary farming operations."

(ii) Remuneration paid for services performed by an employee in the employ of any person in connection with any of the following is excepted as remuneration for agricultural labor, provided such services are performed as an incident to the preparation of such fruits and vegetables for market. For example, if services in the sorting, grading, or storing of fruits, or in the cleaning of beans, are performed as an incident to their preparation for market, remuneration paid for such services may be excepted whether the services are performed in the employ of a farmer, a farmers' cooperative, or a commercial handler of such commodities.

(iii) The services described in subdivisions (i) and (ii), above, do not include services performed in connection with commercial canning or commercial freezing or in connection with the marketing of any agricultural or horticultural commodity after its delivery to a terminal market for distribution for consumption. Moreover, since the services described in such subdivisions must be rendered in connection with a commercial canning or freezing, grading, storing, or delivering to storage or market or to a carrier for transportation to market, of the commodity, they may be within the provisions of subparagraph (3) of this paragraph.

(a) Remuneration paid for domestic service. Remuneration paid for services of a household nature performed by an employee in or about the private home of the person by whom he is employed, or performed in or about the clubrooms or house of a local college club or local chapter of a college fraternity or sorority, by which he is employed, is excepted from the term "wages."

A private home is the fixed place of abode of an individual or family. A local college club or local chapter of a college fraternity or sorority does not include an alumni club or chapter.

If the home is utilized primarily for the purpose of supplying living quarters to the public as a business enterprise, it ceases to be a private home and the remuneration paid for services performed therein is not excepted. Likewise, if the clubrooms or house of a local college club or local chapter of a college fraternity or sorority is used primarily for such purpose, the remuneration paid for services performed therein is not within the exception.

In general, services of a household nature in or about a private home include services rendered by cooks, maids, butlers, valets, laundresses, furnermen, footmen, footmen, and chauffeurs of automobiles for family use. In general, services of a household nature in or about the clubrooms or house of a local college club or local chapter of a college fraternity or sorority, or services rendered by cooks, maids, butlers, laundresses, furnermen, waiters, and housemothers.

The remuneration paid for the services above enumerated is not within the exception if performed in or about rooming or lodging houses, boarding houses, clubs (except local college clubs), hotels, hos-
Remuneration paid for services performed as a private secretary, even though performed in the employer's home, is not within the exception.

(c) Remuneration for casual labor not in the course of employer's trade or business. "Casual labor" includes labor which is occasional, incidental, or irregular.

The expression "not in the course of the employer's trade, or business" includes labor which is occasional, incidental, or irregular.

The remuneration paid for casual labor, that is, labor which is occasional, incidental, or irregular, and does not promote or advance the employer's trade or business, is excepted.

Example. A's business is that of operating a sawmill. He employs B, a carpenter, at an hourly wage to repair his home. B works irregularly and spends the greater part of two days in completing the work. Since B's labor is casual and is not in the course of A's trade or business, the remuneration paid for such services is excepted.

The remuneration paid for casual labor, that is, labor which is occasional, incidental, or irregular, but which is in the course of the employer's trade or business, does not come within the above exception.

Example. C's business is that of operating a sawmill. He employs D for two hours, at an hourly wage, to remove saw dust from his mill. D's labor is casual since it is occasional, incidental, or irregular, but it is in the course of C's trade or business and the remuneration paid for such labor is not excepted.

Example. E is engaged in the business of operating a department store. He employs F for two hours to fill orders in his absence. While the services of the clerks may be casual, they are in the course of the employer's trade or business and, therefore, the remuneration paid for such services is not excepted.

Remuneration paid for casual labor performed for a corporation does not come within this exception.

(1) Compensation paid by nonresident alien individual, foreign partnership, or foreign corporation. Remuneration paid for services performed as an employee of a nonresident alien individual, foreign partnership, or foreign corporation, if such individual, partnership, or corporation is not engaged in trade or business in the United States, is excepted. The exception has no application if the employer paying such remuneration is engaged in trade or business in the United States. Whether or not a nonresident alien individual, foreign partnership, or foreign corporation is engaged in trade or business within the United States depends upon the particular facts of each case and will be determined in accordance with the rules applicable under sections 211, 219, and 231 for income tax purposes generally.

For purposes of this exception, the citizenship or residence of the employee or the place where the services are performed is immaterial.

(2) Compensation paid by foreign government or wholly-owned instrumentalities. Remuneration paid for services performed as an employee of a foreign government or wholly-owned instrumentalities thereof is excepted. The exception includes not only remuneration paid for services performed by ambassadors, ministers, ministers, ministers, legates, diplomatic officers and employees but also remuneration paid for services performed as a consul or other officer or employee of a foreign government, or as a diplomatic representative of a foreign government.

The remuneration paid for services performed as a private secretary, even though performed in the employer's home, is not within the exception.

(d) Compensation paid by foreign employer or foreign corporation. Remuneration paid for services performed by an employee of a foreign employer or foreign corporation, is excepted. The term "United States" includes the several States, the Territories of Alaska and Hawaii, and the District of Columbia.

The exception relates only to the remuneration paid for services performed outside the United States. The remuneration paid by an employer for services performed outside the United States does not constitute wages and hence is not subject to withholding unless the major part of the services performed by the employee during the calendar year is performed within the United States.

The term "United States" includes the several States, the Territories of Alaska and Hawaii, and the District of Columbia.

The exception relates only to the remuneration paid for services performed outside the United States regardless of whether the major part of the services performed for such employer during the calendar year is performed within the United States.

Thus, if an employee performs services outside the United States for more than six months of the calendar year, the remuneration paid for such services does not constitute wages and hence is not subject to withholding; but the remuneration paid for services performed within the United States for such employer during the remainder of the calendar year constitutes wages and is subject to withholding.

If, however, an employee is absent from the United States on business of his employer for less than six months of the calendar year and performs services for such employer within the United States during the remainder of the calendar year, the entire amount of the remuneration paid for services performed during the calendar year constitutes wages and is subject to withholding.

However, it is recognized that in the case of an employee performing services outside the United States, services of indefinite duration, it may be impossible for the employer to determine whether the major portion of the employer's services during the calendar year will be performed within the United States or outside the United States. In such case it may be presumed that such performance will continue throughout the calendar year and the liability of the employer with respect to withholding tax on the compensation paid for such services performed outside the United States will be determined in the light of such presumption. Thus, if an employee undertakes for his employer the performance of services abroad of indefinite duration, or for a term extending beyond the end of the calendar year, and such employee has not already within the calendar year, performed services for such employer within the United States for a length of time which would constitute, in any circumstances, the major part of the year's services for such employer, no tax is required to be withheld on the compensation paid for services performed by such employee outside the United States.

Example. (1) A has been regularly employed by B, and is sent abroad under such conditions that it is not possible to know when or whether he will return. If on January 1, no tax is required to be withheld on compensation paid to A for services performed abroad, but on the compensation paid for services performed after his return on the United States tax should be withheld.

(b) If A goes abroad on June 29, the same rule is applicable. No tax is required to be withheld on the compensation paid for services performed abroad but on compensation paid for services performed after his return to the United States tax should be withheld. (c) If A goes abroad on August 1, tax should be withheld on the compensation paid A for all services performed during the calendar year since under no circumstances could the major portion of the services performed during such year be performed outside the United States.

Example. (2) A begins his employment with B on July 1, and on September 1 is sent abroad under the circumstances described in example (1). No tax is required to be withheld on the compensation paid to A for services performed abroad.

Example. (3) A begins his employment with B on July 1, and on November 1 is sent abroad under the circumstances described in example (1). Tax is required to be withheld on the compensation paid to A for the services performed abroad, as well as on compensation paid for services performed within the United States, for the reasons set forth in example (1) (e).

The presumption that employees performing services of indefinite duration outside the United States will continue to perform such services throughout the calendar year does not apply in the case of employees sent abroad during the year on business missions of limited duration where there is reasonable expectation that the employee can and will return at such time that the major portion of his services for the employer for that calendar year will be performed within the United States.

§ 29.465-5 Employee. The term "employee" includes every individual per-
forming services if the relationship between him and the person for whom he performs such services is the legal relationship of employer and employee. The term specifically includes officers and employees, whether elected or appointed, of the United States, a State, Territory, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing.

Generally the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to his work or job, but as to his manner of doing his work as well. The right to discharge is also an important factor indicating that the person possessing that right is an employer. Other factors characteristic of an employer, but not necessarily present in every case, are the furnishing of tools and the furnishing of a place to work, to the individual who performs the services. In general, if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is an independent contractor and is not as such to perform services as an independent contractor is not as such to perform services as an independent contractor.

Generally, physicians, lawyers, dentists, veterinarians, consultants, subcontractors, public stenographers, auctioneers, and others who follow an independent trade, business, or profession, in which they offer their services to the public, are independent contractors and not employees.

Whether the relationship of employer and employee exists will in doubtful cases be determined upon an examination of the particular facts of each case. Thus, if such relationship exists, it is of no consequence that the employee is designated as a partner, coventurer, agent, or independent contractor.

The measurement, method, or designation of compensation is also immaterial, if the relationship of employer and employee in fact exists. No distinction is made between classes or grades of employees. Thus, superintendents, managers, and other superior employees are employees. An officer of a corporation is an employee of the corporation, however, if he performs services for the corporation other than those required by attendance at and participation in meetings of the board of directors.

Although an individual may be an employee under the statute, his services may be of such a nature, or performed under such circumstances, that the remuneration paid for such services does not constitute wages within the meaning of section 605 (b). (See §29.465-3.)

§29.465-3 Employer. The term "employer" includes any person for whom any individual performs services, of whatever nature, as the employee of such person. An employer may be an individual, a corporation, a partnership, a trust, an estate, a joint-stock company, an association, or a syndicate, group, pool, joint venture, or other unincorporated organization, group, or entity. A trust or estate, rather than the fiduciary which it is the legal representative or instrumentality of any one or more of the foregoing.

The term "employer" embraces not only individuals and organizations engaged in trade or business, but organizations exempt from income tax, such as religious and charitable organizations, educational institutions, clubs, social organizations, and societies, as well as the governments of the United States, the States, Territories, and the District of Columbia, including their agencies, instrumentalities, and political subdivisions.

Although a person may be an employee under the statute, services performed in his employ may be of such a nature, or performed under such circumstances, that the remuneration paid for such services does not constitute wages within the meaning of section 605 (b). (See §29.465-3.)

Sec. 466. Tax collected at source [as added by sec. 172 (a), Rev. Act 1932].

(a) Requirement of withholding. There shall be withheld, collected, and paid upon all wages of every person, to the extent that such wages are includible in gross income, a tax equal to 1 per centum of the excess of each payment of such wages over the withholding deduction allowable under this part.

For weekly pay-roll period

<table>
<thead>
<tr>
<th>Wage bracket</th>
<th>Withholding deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>$9.40 plus $3 of the excess over $20</td>
<td>$12</td>
</tr>
<tr>
<td>$90.30 plus $3 of the excess over $200</td>
<td>$21</td>
</tr>
</tbody>
</table>

For biweekly pay-roll period

<table>
<thead>
<tr>
<th>Wage bracket</th>
<th>Withholding deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>$9.40 plus $3 of the excess over $20</td>
<td>$12</td>
</tr>
<tr>
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<td>$21</td>
</tr>
</tbody>
</table>

(2) If a pay-roll period in respect of any wages is less than one week, the excess of the aggregate of the wages paid during each calendar week over the deduction allowed by this subsection for the weekly pay-roll period shall be used in computing the tax required to be withheld.

(3) A pay-roll period in respect of any wages, or any other period with respect to which wages are paid, is not otherwise specifically provided for in this subsection, the deduction allowable against each payment of such wages shall be the deduction allowable in the case of an annual pay-roll period divided by 52 and multiplied by the number of days in such period, including Sundays and holidays.

(4) In any case in which wages are paid by an employer without regard to any pay-roll period or other period, the deduction allowable against each payment of such wages shall be the deduction allowable in the case of an annual pay-roll period divided by 365 and multiplied by the number of days (including Sundays and holidays) which have elapsed since the date of the last payment of such wages by such employer during the calendar year, or the date of commencement of employment with such employer subsequent to January 1 of such year, whichever is the later.

(5) The deduction allowable under this subsection in respect of any individual for any calendar year shall not exceed the total deduction which would have been allowable under paragraph (1) if the only pay-roll period of such individual had been an annual pay-roll period.

Tax bracket withholding. (1) At the election of the employer, if his pay-roll period with respect to an employee is weekly, biweekly, semimonthly, or monthly, he shall be permitted to withhold income tax on such pay-roll period or such other period as he may elect, and to make the returns and pay the tax required to be withheld under subsection (a) on the basis of a tax table applicable to the pay-roll period.

For weekly pay-roll period

<table>
<thead>
<tr>
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<th>Withholding deduction</th>
</tr>
</thead>
<tbody>
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For biweekly pay-roll period

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<tr>
<td>$90.30 plus $3 of the excess over $200</td>
<td>$21</td>
</tr>
</tbody>
</table>
§ 29.466-1 Requirement of withholding—(a) In general. Subject to certain prescribed conditions, section 465 provides, at the election of the employer or his agent, alternative methods for computing the tax with respect to wages includible in gross income: (1) A tax equal to 5 percent of the excess of each payment of such wages over a specified deduction (hereinafter referred to as withholding exemption) allowable under section 465 (b), or (2) a tax determined in accordance with the tables provided in section 466 (c). See § 29.466 (c). The tax is applicable to all wages actually or constructively paid on or after January 1, 1943, regardless of the period for which paid or the method of accounting followed by the employee in computing his income for tax purposes, and is collected by deducting the amount thereof from such wages as and when so paid.

Example (1). Employer X has a semi-monthly pay-roll period ending on the 15th and 30th days of the month. The wages earned by W, who is customarily paid on the 16th and 31st days of the month, respectively, are constructively paid on the 16th and 31st days of the month, respectively. The wages earned during the semi-monthly period ending on January 10, 1943, are subject to withholding when paid.

Wages are constructively paid within the meaning of this section when they are credited to the account of or set apart for an employee so that they may be drawn upon by him at any time although not then actually reduced to possession. To constitute payment in such a case, the wages must be credited or set apart to the employee without any substantial limitation or restriction as to the time or manner of payment or condition under which payment may be made, and must be reducible to cash so that they may be drawn upon at any time, and their payment brought within his control and disposition.

§ 29.466-2 Withholding exemption—(a) In general. In computing the amount of the tax to be withheld from wage payments, a withholding exemption is allowable against the wages paid by each employer to each resident of the United States at any time during the calendar year upon which an annual exemption of $294 is claimed in accordance with the length of the particular pay-roll period. Under the schedule provided in section 465 (c) (1), the amount of the exemption is as follows:

<table>
<thead>
<tr>
<th>Pay-roll period</th>
<th>Withholding exemption</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weekly</td>
<td>$12.00</td>
</tr>
<tr>
<td>Biweekly</td>
<td>24.00</td>
</tr>
<tr>
<td>Semi-monthly</td>
<td>48.00</td>
</tr>
<tr>
<td>Quarterly</td>
<td>120.00</td>
</tr>
<tr>
<td>Annually</td>
<td>$240.00</td>
</tr>
</tbody>
</table>

The amount of the exemption in respect of the wages paid a particular employee is determined by reference to such employee's pay-roll period and without regard to the time the employee is actually engaged in the performance of services during such period.

Example (1). Employer X has a semi-monthly pay-roll period. An employee whose wages are determined on an hourly rate basis works 100 hours per pay-roll period. The amount of the withholding exemption allowable in respect of such wages is $48.00.

Example (2). Employer Y has a weekly pay-roll period. An employee paid at the rate of $10 per day worked 5 days and received no overtime. The amount of the withholding exemption allowable in respect of such wages is $12.00.

§ 29.466-3 Pay-roll period less than one week. If the pay-roll period is less than one week, as in the case where employees who are paid daily, the amount of tax withheld will be based upon the excess of the aggregate of the wages paid during the period of a calendar week over the exemption which would be allowed for a weekly pay-roll period. For instance, if an employee is paid daily at the rate of $5 per day, no tax shall be withheld with respect to the wages paid for the three pay-roll days of employment in the week. The wages paid for the third day will be subject to withholding on §3, the excess of the total wages for three days

1This part comprises sections 465 to 470, inclusive.
§ 29.466–3 Wage bracket withholding. 

The use of the tables provided in section 466 (c) is optional with the employer. An employer may elect to use the wage bracket tables for the determination of the amount of the tax to be withheld in the case of any one or more of his employees provided that such employees are paid on a weekly, biweekly, semimonthly, or monthly basis. For the purpose of such elections the employer may elect to use the optional method in case of one group of employees on a particular pay roll and at the same time may use the exact 5 percent method provided in section 466 (b) for the withholding of another group of employees on a different pay roll.

In order to determine the amount of the tax to be withheld with respect to any wage payment, the employer merely refers to the table applicable to the particular pay-rroll period. For example, an employer's earnings for a weekly pay-roll period of the week ending November 18, 1943, may be used to determine the tax owed in respect to the table applicable to a weekly pay-roll period, it will be found that the $35 wage payment falls within the wage bracket from $38 to $38 and the amount of the tax to be withheld shown opposite such bracket is $1.10.

If an employer elects in the case of any employee to determine the tax under the wage bracket tables and such employee is paid in addition to his regular wages extra compensation in the form of bonuses, commissions, etc., no withholding exemption allowable under section 466 (b) is allowable for the purpose of computing the amount of the tax to be withheld under the table. For example, a salesman employed at a monthly salary of $100 plus commissions and sales made during each month received for a particular month in addition to his regular salary, commissions amounting to $150. By reference to the table applicable to a monthly pay-roll period, it will be found that the $250 wage payment falls within the wage bracket from $240 to $280 and the amount of the tax to be withheld shown opposite such bracket is $10.40.

(b) If the employee's compensation consists of wages paid with respect to a particular pay-roll period and additional wages in the form of bonuses, commissions, etc., paid with respect to a different period or without regard to any particular period, the amount of the withholding exemption allowable for the purpose of determining the appropriate wage bracket and the amount of the tax to be withholding under the table is the aggregate of the wages paid for each pay-roll period considered as a single wage payment for the purpose of computing the maximum allowance of $624 for the calendar year. In the case of such individuals, no withholding exemption is allowable with respect to any further wages paid to such employee by the same employer during the calendar year or the subsequent period. Thus, if an employee's wages for a semimonthly pay-roll period are less than $38 the difference between such wages and the $38 exemption allowable with respect to such pay-roll period may not be carried forward to the subsequent pay-roll period.

(c) Wages paid without regard to any period. In the case of wages paid without regard to any particular period, as, for example, commissions paid to a salesman at a specified rate per hour plus a bonus on production in excess of a fixed standard, the withholding exemption is determined by multiplying the annual withholding exemption of $624 by the hourly rate of the commission paid on May 20 is $400. Thus, the withholding exemption allowable for a pay-roll period of 10 days is $17.10.

(d) Maximum withholding exemption. Under section 466 (b) (5) the total withholding exemption allowable to any individual with respect to wages received from any one employer during a calendar year or a part thereof which together with his regular monthly salary of $800 make a total of $265.

The amount of the withholding exemption allowable with respect to the aggregate wages of $425 is $52.
propriate wage table, and the amount of the tax to be withheld on the additional wages shall be 5 percent of each such wage payment. (2) The aggregate of the additional wages and the regular wages shall be considered as a single wage payment and the amount of the tax to be withheld shall be determined under the tax tables to the regular pay-roll period. For example, an employee is paid a weekly salary of $85 plus a bonus determined at the end of each 3-month period. For a particular 3-month period, the employee is paid a bonus of $70. Under the method provided in (1), the amount of the tax to be withheld on the weekly wages as shown on the table provided for a weekly pay-roll period is $3.00, and the amount of the tax to be withheld on the bonus is 5 percent of $70, or $3.50. Under the method provided in (2), the amount of the tax to be withheld on the aggregate is $80 plus $1.40, or $81.40, applicable to a weekly pay-roll period is $8.10.

If, in the case of an employee, the wage bracket tables for determining the amount of the tax to be withheld are used for only a portion of the calendar year, and the exact 5 percent method is used for the balance of the calendar year, the maximum withholding exemption allowable to the wage paid by such employer to such employee during the portion of the calendar year following such change shall not exceed the product of the withholding exemption applicable with respect to such employee's pay-roll period multiplied by the number of such periods in the remaining portion of the calendar year.

Example. In the case of certain employees having a weekly pay-roll period ending on Thursday of each week, an employer used the wage bracket tables for determining the tax to be withheld during the first quarter of the calendar year 1943. For the pay-roll period ending on Thursday, April 1, 1943, and for subsequent periods during the calendar year 1943, the employer used the exact 5 percent method for computing the amount of the tax to be withheld. The maximum withholding exemption allowable with respect to the wages paid each employee during the balance of the calendar year 1943 shall be determined by multiplying the maximum maximum withholding exemption allowable to a weekly pay-roll period (multiplied by 40 (the number of weekly pay-roll periods remaining in the calendar year), or $800.

§ 29.464-4 Tax paid by recipient. Section 466 (d) provides that if the tax required to be withheld, collected, and paid by the withholding agent is paid by the recipient, then the tax shall shall be re-collected from the withholding agent. Such payment does not, however, operate to relieve the withholding agent from liability for interest or additions to the tax imposed for failure to withhold, collect, and pay, the tax within the time prescribed by law or regulations made in pursuance thereof. If additions to the tax shall be computed from the date prescribed in section 468 for the making of the return and payment of the tax by the withholding agent to the date of payment of the tax by the recipient of the income, in general, for interest and additions to tax for failure to make re-

turn or pay the tax within the time prescribed by law, see sections 251 to 259, inclusive. For minimum addition to tax for failure to make return within the time prescribed by law, see section 470 (c).

§ 29.465-5 Return of income and credit for tax withheld at source. The entire amount of the wages from which the tax is withheld shall be included in gross income in the return required to be made by the recipient of wages without deduction for such tax. The tax withheld at source, however, is allowable as a credit against the victory tax imposed upon the recipient of the income and any excess thereof over the amount of the victory tax is allowable as a credit against the tax imposed by chapter 11 or the tax imposed by section 409, as the case may be. Any excess of the tax withheld at source over the aggregate of the tax imposed by chapter 1 shall be refunded to the recipient of the income. If the tax has actually been withheld at source, the refund shall be made to the recipient of the income even though such tax has not been paid over to the Government by the withholding agent. See section 332. For the purpose of the credit, the recipient of the income is the person subject to the tax imposed under chapter 1 upon the wages from which the tax was withheld. For instance, if a husband and wife are located in a community property State and make separate returns, each reporting for income tax purposes one-half of the wages received by the husband, each spouse is entitled to one-half of the credit allowable for the tax withheld at source with respect to such wages.

Example. A and B are married and living together and have two dependent children throughout the calendar year 1943. Their joint return for 1943 discloses a gross income of $1,075.02, a surtax of $62.80, and victory tax (gross) of $180 under the farm and city income. If the tax has actually been made to the recipient of the income even though such tax has not been paid over to the Government by the withholding agent. See section 332. For the purpose of the credit, the recipient of the income is the person subject to the tax imposed under chapter 1 upon the wages from which the tax was withheld. For instance, if a husband and wife are located in a community property State and make separate returns, each reporting for income tax purposes one-half of the wages received by the husband, each spouse is entitled to one-half of the credit allowable for the tax withheld at source with respect to such wages.

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Example (1). Employee A is employed by B who operates a farm and a store. The remuneration paid A for services on the farm is excepted as remuneration for agricultural labor, and the remuneration for services performed in the store constitutes wages. Employee A is paid a weekly salary of $300. Employee A works 120 hours on the farm and 120 hours in the store. None of the remuneration paid A for services performed during the month is deemed to be wages, since the remuneration paid for less than one-half of the services performed during the month constitutes wages.

During another month A works 72 hours on the farm and 120 hours in the store. All of the remuneration paid A for services performed during the month is deemed to be wages since the remuneration paid for one half or more of the services performed during the month constitutes wages.
The rules set forth in this section do not apply with respect to any remuneration paid for services performed by an employee for his employer if the periods for which remuneration is paid by the employer vary to the extent that there is no period which constitutes a pay-roll period within the meaning of section 466(a). In such a case withholding is required with respect to that portion of such remuneration which constitutes wages.

Sec. 2967. Withholding agent (as added by sec. 172(a), Rev. Act 1943). (a) Collection of tax. The tax required to be withheld by section 466 shall be collected by the person having the payment of such wages or under such circumstances as to deduct such amount from such wages as and when paid. As used in this subsection, the term "person" includes officers and employees of the United States, or of a State, Territory, or any political subdivision thereof, or of the District of Columbia.

(b) Indemnification of withholding agent. Every person required to withhold and collect any tax shall be indemnified by the person liable for the payment of such tax, and shall not be liable to any person for the amount of any such payment.

(c) Adjustments. If more or less than the correct amount of tax is withheld or paid for any quarter in any calendar year, proper adjustments, made both with respect to the tax withheld or the tax paid, may be made in any subsequent quarter of such calendar year, without interest, in such manner and at such times as may be prescribed by regulations made by the Commissioner, with the approval of the Secretary.

§ 29467-1 Collection and liability for tax. Under the provisions of section 467, the withholding agent is required to collect the tax by deducting the amount thereof from the employee's wages as and when paid, either actually or constructively. The withholding agent is required to collect the tax, not withstanding the wages are paid in something other than money (for example, wages paid in stock or bonds; see § 29465-2) and to pay the tax to the collector in money. If the tax is in property other than money, necessary arrangements should be made between the employer and employee to insure that the amount of the tax is available for payment to the collector.

Every person required to withhold and collect the tax under section 466 from the wages of an employee is liable for the payment of such tax whether or not it is collected from the employee. If, for example, an employer deducts less than the correct amount of tax, or if he fails to deduct any part of the tax, he is nevertheless liable for the correct amount of tax. See, however, section 466(d), relieving the withholding agent from liability for the tax if such tax has been paid by the recipient of the income. The amount of any tax withheld and collected by a withholding agent is a special fund in trust for the United States (see sec. 3661). Except as otherwise expressly indicated or manifestly inconsistent there with all provisions of law, including statutes of limitations, applicable with respect to the assessment and collection and refund or credit of the taxes imposed by chapter 1 are applicable to the tax required to be withheld.

The withholding agent is relieved of liability to any other person for the amount of any tax withheld and paid to the collector pursuant to the provisions of section 466(a). In such a case withholding is required with respect to that portion of such remuneration which constitutes wages.

§ 29467-2 Quarterly adjustments—(a) In general. If, for any quarter of the calendar year, more or less than the correct amount of the tax is withheld, or more or less than the correct amount of the tax is paid, the withholding agent may make an adjustment, without interest, may be made in any subsequent quarter of the same calendar year. No adjustment, however, under the provisions of this section shall be made in any quarter after the mailing of a statutory notice of deficiency under the provisions of section 272, the making of a jeopardy assessment under the provisions of sections 7561, 7562, 7563, or the filing of a claim for refund under the provisions of section 7562, in respect of such quarter. Every return on which an adjustment for a preceding quarter is reported must have securely attached as a part thereof a statement, in duplicate, explaining the adjustment, and designating the quarterly return period in which the error occurred. If an undercollection of tax which the withholding agent has repaid to an employee is reported on a return, such statement shall include the fact that such tax was repaid to the employee.

(b) Less than correct amount of tax withheld. If, on any return, less than the correct amount of tax is deducted from any wage payment and the error is ascertained prior to the making of the return and the amount on such return is paid to the collector, the amount of any undercollection adjusted in accordance with this subsection shall be paid to the collector, without interest, at the time prescribed for payment of the tax for the quarter in which such adjustment is made. If an adjustment is made pursuant to this subsection, the amount thereof is not paid when due, interest thereafter accrues. See section 294. If none, or less than the correct amount of the tax is withheld from any wage payment, the withholding agent may correct the error by deducting the amount of the undercollection from the remuneration of the employee, if any, under his control after he ascertains the error. Such deduction may be made even if the error is not ascertainable or manifestly inconsistent there with. Such deduction may be made even though the remuneration, for any reason, does not constitute wages. The obligation of an employee to the withholding agent with respect to an undercollection of tax from the employee's wages not subsequently corrected by a deduction made as prescribed herein is a matter for settlement between the employee and the withholding agent. In connection with the withholding, section 466(d) relieving the withholding agent from liability for collection of the tax if such tax has been paid by the employee or other recipient of the remuneration.

(c) More than correct amount of tax withheld. If, in any quarter, more than the correct amount of tax is deducted from any wage payment, the overcollection may be repaid to the employee on any quarter of the same calendar year. If the amount of the overcollection is repaid, the withholding agent shall obtain and keep as part of his records the written receipt of the employee showing the date and amount of the repayment. If an overcollection in any quarter is repaid and receipted for by the employee prior to the time the return on Form V-1 for such quarter is filed with the collector, the amount of such overcollection shall not be included in the return for such quarter.

§ 29468. Return and payment by withholding agent (as added by sec. 172(a), Rev. Act 1943). In lieu of the time prescribed in sections 55 and 63 for the return and payment of the tax imposed by this chapter, every person required to withhold and collect any tax under section 466 shall file with the collector of Internal Revenue for the district in which is located his principal place of business or office, a return of such tax on or before the last day of the month following the close of each quarter of the calendar year. Such return shall include with the final return for the calendar year a duplicate copy of each receipt required to be turned over to the employee. Every such person shall also keep such records and render under oath such statements with respect to the tax so withheld and collected as may be required under regulations prescribed by the Commissioner, with the approval of the Secretary.

§ 29468-1 Return and payment by withholding agent. Every person required to withhold and collect any tax under section 466 shall make a return and pay such tax on or before the last day of the month following the close of each of the quarters ending March 31, June 30, September 30, and December 31. Such return is to be made on Form V-1, Return of Victory Tax Withheld, and must be filed with the collector of Internal Revenue for the district in which is located his principal place of business or office of the employer, or if he has no principal place of business or office, then in the district in which is located his legal residence. There shall be included with the return filed for the fourth quarter of the calendar year, or with the
statements (Form V-2), they may be forwarded to the collector in a separate package, properly identified by reference to the return (Form V-1). The last return on Form V-2 shall be furnished to the collector on or before the thirtieth day after the close of the calendar year, or, if his employment is terminated during the calendar year, on or before January 31 of the succeeding calendar year, on the day on which the last payment of wages is made. Statements showing the period covered by the statement, the wages paid by the employer to such employee during such period, and the amount of tax withheld and collected under this part in respect of such wages.

(b) Regulations. The statements required to be furnished shall be in lieu of the return required to be furnished by the employer respect of his employment during the calendar year, or, before January 31 of the succeeding calendar year, if his employment is terminated before the close of such calendar year, to the employer on the day on which the last payment of wages is made. Statements of Victory Tax Withheld (Form V-3) shall be furnished to the employer in respect of the wages paid by him or by any employer engaged in seasonal activities, and shall be furnished to the collector on or before the thirtieth day after the close of the calendar year, or, if his employment is terminated during the calendar year, the last day of the calendar year, or, if his employment is terminated during the calendar year, on or before January 31 of the succeeding calendar year, on the day on which the last payment of wages is made.

(c) Extension of time. The Commissioner, under such regulations as he may prescribe in the manner, at the time, and in such form as the Commissioner, with the approval of the Secretary, may prescribe, may grant to any employer a reasonable extension of time (not in excess of 20 days) with respect to the statements required to be furnished to employees on the day on which the last payment of wages is made. Statements prepared in duplicate, the original of which shall be furnished to the employee as a record of the wages paid to him and the tax withheld, and the duplicate shall be retained by the employer for a period of three years.

§ 29.669-1 Receipts for tax withheld at source on wages.—(a) In general. Every employer or person required to withhold tax on wages shall be required to withhold, collect, and pay the tax. The return must be signed and sworn to by the person to whom the business was sold or otherwise transferred to another person, the name and address of such person and the date on which such sale or other transfer took effect. If no such sale or transfer occurred or the employer does not know the name of the person to whom the business was sold or transferred, that fact should be included in the statement. An employer who has only temporarily ceased to pay wages, including an employer engaged in seasonal activities, shall continue to pay wages on the face of any return on which no tax is required to be reported showing the date of the last payment of wages and the date when he expects to resume paying wages. If any payment of wages is made within 30 days from the time the statement required by section 465 (a) is granted any employer with respect to which such payment of wages is made within the calendar year, there is no requirement that a statement be immediately furnished the employer; but when such expectation ceases to exist, the statement must be furnished within 30 days from that time.

§ 29.740-1 Penalties.—(a) Fraudulent receipt or failure to furnish receipt. Section 470 imposes criminal and civil penalties for the willful failure to furnish a receipt for the tax paid by the employee or showing the information required under section 469 or regulations prescribed thereunder or for willfully furnishing a false or fraudulent receipt. The criminal penalty is a fine of not more than $1,000 or imprisonment for not more than one year, and the civil penalty is a fine of not more than $50 for each such violation. Such penalties are in lieu of any other penalty provided by law respecting the failure to furnish a receipt or the furnishing of a false or fraudulent receipt.

(b) Additional penalty. In addition to the penalty provided by subsection (a) of this section, if the Commissioner in pursuance of section 469 furnishes a receipt in respect of tax withheld pursuant to this part who willfully furnishes a false or fraudulent receipt, or who willfully fails to furnish a receipt in the manner, time, and at the time, and showing the information required under section 469, or regulations prescribed thereunder, shall be assessed a penalty for each such failure. This penalty shall be subject to a civil penalty, of not more than $50.

(c) Failure of withholding agent to file return. In case of any failure to make and file return required by this part, within the time prescribed by law or prescribed by the Commissioner in pursuance of section 469, any employee who has not furnished the statement required by section 465 (a) shall be assessed a penalty of not more than $50 for each such failure.

(d) Additional penalty. In addition to the penalty provided by subsection (b) of this section, if the Commissioner in pursuance of section 469 or regulations prescribed thereunder or for willfully furnishing a false or fraudulent receipt, shall be assessed a penalty of not more than $50 for each such violation.

(e) Additional penalty. In addition to the penalty provided by subsection (d) of this section, if the Commissioner in pursuance of section 469 or regulations prescribed thereunder or for willfully furnishing a false or fraudulent receipt, shall be assessed a penalty of not more than $50 for each such violation.
221 to 229, inclusive; for criminal penalties, see section 145 and §124.1-15.

EXPIRATION DATE AND DEFINITIONS

Sec. 476. Definitions [as added by sec. 172 (a), Rev. Act 1942].
(a) Net income. When used in this title, where not otherwise distinctly expressed or 2
manually, the term “net income” shall be construed to mean “victory tax net income” for 3
the purposes of this chapter.

(b) Date of cessation of hostilities in the present war. As used in this subchapter, the term “date of cessation of hostilities in the present war” means the date on which hostilities in the present war between the United States and the Governments of Germany, Japan, and Italy cease, as fixed by proclamation of the President or by concurrent resolution of both Houses of Congress, whichever date is earlier, or, in case the hostilities between the United States and such Governments do not cease at the same time, such date as may be so fixed as an appropriate date for the purposes of this subchapter.

§29.475–1 Definitions—(a) Net income as victory tax net income. The term “net income” as used throughout the Internal Revenue Code, where not otherwise distinctly expressed or manually, shall be construed to mean “victory tax net income” for the purposes of the victory tax.

(b) Date of cessation of hostilities in the present war. The term “date of cessation of hostilities in the present war” means the date on which hostilities in the present war between the United States and the Governments of Germany, Japan, and Italy cease, as fixed by proclamation of the President or by concurrent resolution of both Houses of Congress, whichever date is earlier, or, in case the hostilities between the United States and such Governments do not cease at the same time, such date as may be fixed by proclamation of the President or by concurrent resolution of both Houses of Congress as an appropriate date for the purposes of the victory tax.

Sec. 476. Expiration date [as added by sec. 172 (a), Rev. Act 1942, and amended by sec. 2 (c), Current Tax Payment Act 1943].

The tax imposed by Part I of this subchapter shall not apply with respect to any taxable year commencing after the date of cessation of hostilities in the present war. The tax imposed by Part I and Part II of such subchapter shall not apply with respect to any wages paid after June 30, 1945, unless paid during the calendar year 1943 with respect to a payroll period beginning on or before such date. [Note: Under sec. 2 (a), Current Tax Payment Act 1943, and the amendments by sec. 2 (c) thereof effective July 1, 1943. Prior to such amendment, section 476 read as follows: “The tax imposed by Part I of this subchapter shall not apply with respect to any taxable year commencing after the date of cessation of hostilities in the present war.”]

SUBPART E—PERSONAL HOLDING COMPANIES

Sec. 500. Surtax on personal holding companies [as amended by sec. 110 (a), Rev. Act 1941; sec. 181, Rev. Act 1942].

There shall be levied, collected, and paid, for each taxable year beginning after December 31, 1928, upon the undistributed subchapter A net income of every personal holding company (in addition to the taxes imposed by chapter 1) a surtax equal to the sum of the following:

1) 75 percent of the amount thereof in excess of $2,000; plus
2) 85 percent of the amount thereof in excess of $3,000.

[Norm: Under sec. 101, Rev. Act 1942, the rates of tax specified in this section are applicable only with respect to taxable years beginning after December 31, 1941.]

§29.500–1 Surtax on personal holding companies. This surtax (in addition to the taxes imposed by chapter 1) a graduated income tax or surtax upon corporations classified as personal holding companies and, under the circumstances specified in section 501 (c), upon an affiliated group of railroad corporations. Corporations so classified are exempt from the surtax on corporations improperly accumulating surplus imposed by section 501 (b) except to the extent, if any, that the corporation is a personal holding company with respect to any taxable year beginning after December 31, 1938, then, for each subsequent taxable year, the minimum percentage shall be 70 per centum in lieu of 80 percent, until a taxable year during which the whole of the last half of which the stock ownership required by paragraph (2) does not exist, or until the expiration of the period of 20 successive years of which less than 70 per centum of the gross income is personal holding company income and chapter 2 stock ownership begins at any time during the last half of the taxable year more than 60 per centum in value of its outstanding stock is owned directly or indirectly (including in the case of an individual, stock owned by the members of his family as defined in section 503 (a) and (b)) outstanding at any time during such year do not exceed $30,000 in principal amount.

(2) Exceptions. The term “personal holding company” does not include:

(a) A corporation exempt from taxation under section 101.
(b) A corporation defined in section 104.
(c) A life insurance company.
(d) A surety company.
(e) The amendment of sec. 501 (b), Internal Revenue Code, by sec. 182 (b), Rev. Act 1942, shall be applicable to taxable years beginning after December 31, 1941, except that any tax, whether the tax is imposed by this subchapter or by any law during the taxable year beginning after December 31, 1941, and not beginning after December 31, 1941, shall not be applicable to such taxable years.
(f) Corporations making consolidated returns. The tax imposed by section 500 on an affiliated group of corporations making a consolidated return under the provisions of section 141 satisfies the stock ownership requirement provided in section 501 (a) (2), and the income from such affiliated group, determined as provided in section 501, satisfies the gross income requirement of section 501 (a) (1), shall be subject to the surtax imposed by this subchapter. The preceding sentence shall apply only if the common parent corporation is a common parent of an affiliated group of railroad corporations which would be eligible to file consolidated returns under section 141 prior to its amendment by the Revenue Act of 1942.

§29.501–1 Definition of personal holding company. A personal holding company is any corporation (other than a corporation exempt from tax under section 501 (b) (5), which for the taxable year meets (a) the gross income requirement specified in §29.501–2, and (b) the stock ownership
requirement specified in § 29.501-3. Both requirements must be satisfied and both must be met with respect to each taxable year.

A loan or investment corporation, as defined in §(a)-20, inclusive, and §29.503 (b)-1, is not taxable as a personal holding company. If, for any prior taxable year (or years) beginning after December 31, 1938, and before January 1, 1942, such a corporation classifies as a personal holding company under section 501 (a), it is not subject to the surtax imposed by section 500 for such taxable year (or years) if it elects, within one year after October 21, 1942, to be classified as a personal holding company. This election made only by the filing of a notice in writing with the Commissioner of Internal Revenue, Washington, D. C., attention Income Tax Unit, within such 1-year period, requesting that the exemption granted by section 501 (b) be applied to such prior taxable year (or years) with respect to which the corporation was otherwise subject to surtax as a personal holding company.

§ 29.501-2 Gross income requirement. To meet the gross income requirement, it is necessary that either of the following percentages of gross income of the corporation for the taxable year be personal holding company income as defined in section 501 (a):

(a) 80 percent or more; or

(b) 70 percent or more if the corporation has been classified as a personal holding company for any taxable year beginning after December 31, 1938, unless:

(1) A taxpayable has intervened since the last taxable year for which it was so classified, during each of which its personal holding company income was less than 70 percent of its gross income.

In determining whether the personal holding company income is equal to the gross income for the taxable year, the percentage required by §(a)-20, inclusive.

§ 29.501-3 Stock ownership requirement. To meet the stock ownership requirement, it is necessary that at some time during the last half of the taxable year more than 50 percent of the outstanding stock of the corporation be owned by individuals, for not more than five individuals. For such purpose, the ownership of the stock must be determined as provided in section 508 and §§29.503 (a)-1 to 29.503 (a)-7.

In the event of any change in the stock outstanding during the last half of the taxable year, whether in the number of shares or classes of stock, or whether in the ownership thereof, the conditions existing immediately prior and subsequent to each change must be taken into consideration.

In determining whether the statutory conditions with respect to stock ownership are present at any time during the last half of the taxable year, the phrase "in value" means, in the light of all of the circumstances, the deemed value of the corporate stock outstanding at such time (not including treasury stock).

The deemed value may be determined upon the basis of the company's book value, earning and dividend paying capacity, appreciation of assets, together with such other factors as have a bearing upon the value of the stock. The value of the stock is great of variance with that reflected by the corporate books, the evidence of such value should be filed with the return. In any case where there are two or more classes of stock outstanding, the total value of all the stock should be allocated among the different classes according to the relative value of each class therein.

The rule stated in the last two preceding paragraphs are equally applicable in determining the stock ownership requirement specified in section 502 (a), relating to personal service contracts, and the requirement relating to the use of corporate property by a shareholder. The stock ownership requirement specified in these sections relates, however, to the stock outstanding at any time during the entire taxable year and not merely during the last half thereof.

§ 29.502-1 Personal holding company income. The term "personal holding company income" means the portion of the gross income which consists of:

(a) Dividends. The term "dividends" includes dividends as defined in section 116 (a), and amounts required to be included in gross income under section 337 (b). See §29.115-1.

(b) Interest (other than interest constituting rent). The term "interest" means any amounts, includible in gross income, received for the use of money, except that it does not include amounts constituting interest as the term "rent" is used in subsection (f).

§ 29.502-2 Royalties. Royalties. Royalties, under section 22 (a) (relating to expenses) other than compensation for personal services rendered by the individual owners, constitute 5 per centum or more of the gross income.

§ 29.502-3-personal holding company income. The term "personal holding company income" means the portion of the gross income which consists of:

(a) Dividends. The term "dividends" includes dividends as defined in section 116 (a), and amounts required to be included in gross income under section 337 (b). See §29.115-1.

(b) Interest (other than interest constituting rent). The term "interest" means any amounts, includible in gross income, received for the use of money, except that it does not include rents, or overriding royalties received by an operating company. As used in this paragraph the term "overriding royalties" means amounts received from the sublessee by the operating company which acquired and developed the natural resource property in respect of which such overriding royalties are paid.

(c) Royalties (other than mineral, oil, or gas royalties). The term "royalties" includes amounts constituting the privilege of using patents, copyrights, secret processes and formulas, good will, trade marks, trade brands, franchises, and other like property. It does not include rents, or overriding royalties received by an operating company.

§ 29.502-4-1 Personal holding company income. The term "personal holding company income" means the portion of the gross income which consists of:

(a) Dividends. The term "dividends" includes dividends as defined in section 116 (a), and amounts required to be included in gross income under section 337 (b). See §29.115-1.

(b) Interest (other than interest constituting rent). The term "interest" means amounts, includible in gross income, received for the use of money, except that it does not include interest as the term "rent" is used in subsection (f).

(c) Royalties (other than mineral, oil, or gas royalties). The term "royalties" includes amounts constituting the privilege of using patents, copyrights, secret processes and formulas, good will, trade marks, trade brands, franchises, and other like property. It does not include rents, or overriding royalties received by an operating company.
In gross income. The term "stock or securities" as used in section 502 (b) includes shares or certificates of stock, or interest in any corporation (including any joint-stock company, insurance company, association, or other organization classified by the Internal Revenue Code), certificates of interest or participation in any profit-sharing agreement, or in any oil, gas, or other mineral royalty, or lease, collateral trustees certificates, voting trust certificates, stock rights or warrants, bonds, debentures, certificates of indebtedness, notes, car trust certificates, Bills of exchange, obligations issued pursuant to a contract under which the individual who is to perform the services, for the use of, or the right to use, property of the corporation in which the individual was to perform, is to perform, or may be designated (by name or by description) as the one to perform, such services. For this purpose the "stock or securities" held for speculation by the corporation, to the extent they do not represent the price for which real property held primarily for sale to customers in the ordinary course of its trade or business was sold or exchanged by the corporation, but do not include the amount of deductions allowable for expenses under section 23 (a) (other than compensation for personal service rendered by the shareholders of the corporation) or the aggregate amount of deductions constituting personal holding company income under section 502 (f) and paragraph (1) of this section. However, rents do not constitute personal holding company income if they constitute capital stock or securities held for speculation or interest in an estate or trust.

(1) Gains from futures transactions in commodities. Gains from futures transactions in commodities include gains from futures transactions in any commodity and subject to the rules of a board of trading or futures in the futures market. Such gains shall not include gains from cash transactions or gains by a producer, processor, merchant, or handler of the commodities, received as compensation for the use of, or the right to use, property and the interest on debts owed to the corporation, but do not include amounts received from the lessee by the operating company which originally leased and developed the natural resource property in respect of which such overriding royalties are paid.

Example (1). A, whose profession is that of an operator, owns all of the outstanding capital stock of the M Corporation. The M Corporation entered into a contract with A under which A was to perform personal services for the person or persons whom the M Corporation might designate of which A was to receive $10,000 a year from the M Corporation. The M Corporation entered into a contract with the O Corporation in which the corporation was to perform personal services for the O Corporation in consideration of which the O Corporation was to pay the M Corporation $600,000 a year. The $600,000 received by the M Corporation from the O Corporation constitutes personal holding company income.

(1) Compensation for use of property. The compensation for the use of, or the right to use, property of the corporation which is to be included in personal holding company income consists of amounts received as compensation (however designated and from whomsoever received) for the use of, or the right to use, property of the corporation in any case in which, at any time during the taxable year, 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for an individual entitled to the use of the property, whether such right is obtained directly from the corporation or by means of a substitute for the arrangement. The property may consist of a yacht, a city residence, a country house, or any other kind of property. See section 506 and §§ 29.503 (a)–7, inclusive, §§ 29.503 (a)–7, inclusive, and the last paragraph of § 29.501–3.

(2) Rents (including interest constituting rent). The rents which are to be included in personal holding company income consist of compensation, however designated, including charter fees, etc., for the use of, or the right to use, real property, or any other kind of property and the interest on debts owed to the corporation, to the extent they do not represent the price for which real property held primarily for sale to customers in the ordinary course of its trade or business was sold or exchanged by the corporation, but do not include the aggregate amount of such royalties constituting 50 percent or more of the gross income of the corporation for the taxable year and (2) the aggregate amount of deductions allowable for expenses under section 23 (a) for personal service income received from a person or persons who are not shareholders of the corporation.

(3) Income from mineral, oil, or gas royalties. The income from mineral, oil, or gas royalties is to be included as personal holding company income, unless (1) the aggregate amount of such royalties constitutes 50 percent or more of the gross income of the corporation for the taxable year and (2) the aggregate amount of deductions constituting personal holding company income under section 502 (f) and paragraph (1) of this section. However, rents do not constitute personal holding company income if they constitute capital stock or securities held for speculation or interest in mineral, oil, or gas properties. The term "mineral, oil, or gas royalties" means all royalties, except overriding royalties, received from any interest in mineral, oil, or gas properties. The term "mineral" includes the minerals specified in § 29.23 (m)–(d). As used in this paragraph the term "overriding royalties" means amounts received from the lessee by the operating company which originally leased and developed the natural resource property in respect of which such overriding royalties are paid.

Income from estates and trusts.

The income from estates and trusts which is to be included in personal holding company income consists of amounts received from the sale or other disposition of any interest in an estate or trust.

(b) Amounts received under personal service contracts. Amounts includible in personal holding company income as amounts received under personal service contracts consist of amounts received pursuant to a contract under which the corporation is to furnish personal services, and amounts received from a sale or other disposition of such a contract, if:

(1) Some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in a clause of stock or securities held for speculation by the corporation, to the extent they do not constitute personal holding company income if they constitute capital stock or securities held for speculation or interest in mineral, oil, or gas properties. The term "mineral, oil, or gas royalties" means all royalties, except overriding royalties, received from any interest in mineral, oil, or gas properties. The term "mineral" includes the minerals specified in § 29.23 (m)–(d). As used in this paragraph the term "overriding royalties" means amounts received from the lessee by the operating company which originally leased and developed the natural resource property in respect of which such overriding royalties are paid.

Size 503. Stock ownership.

(a) Constructive ownership. For the purposes of determining whether a corporation is a personal holding company, insofar as such dividends and the like are includible in gross income under section 501 (a) (2), section 502 (f), or section 502 (b)–1.

(1) Stock owned by individual. Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by its shareholders, partners, and beneficiaries.

(b) Family and partnership ownership. An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family by or for his partner. For the purposes of this paragraph the family of an individual includes only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

(2) Options. If any person has an option to acquire stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust, such person shall be considered as owning such stock, and the aggregate amount of deductions constituting personal holding company income under section 502 (f) and paragraph (1) of this section shall be included in personal holding company income.

(3) Application of family-partnership and option rules. Paragraphs (2) and (3) shall be applied—

For the purposes of the stock ownership requirement provided in section 501 (a) (2), if, but only if, the effect is to make the corporation a personal holding company; and for the purposes of section 502 (f) (relating to personal service contracts), or of section 502 (b) (relating to the use of property by shareholders), if, but only if, the
effect is to make the amounts therein referred to includable under such subsection as personal holding company income.

(3) Constructive ownership as actual ownership. Stock constructively owned by a person by reason of the application of paragraph (1) or (2) shall, for the purpose of applying paragraph (1) or (2), be treated as actually owned but stock constructively owned by an individual by reason of the application of paragraph (2) shall not be treated as actually owned by him for the purpose of again applying such paragraph in order to make another the constructive owner of such stock.

(9) Option rule in lieu of family and partnership rule. If stock may be considered as owned by an individual under either paragraph (a) or paragraph (b) it shall be considered as owned by him under paragraph (9).

§ 29.503 (a)-1 Stock ownership. For the purpose of determining whether:

(a) A corporation is a personal holding company, in so far as such determination is based on the stock ownership requirement specified in section 501 (a) (2) and § 29.501-3, or

(b) Amounts received under a personal service contract or from the sale of such a contract personally held company income in so far as such determination is based on the stock ownership requirement specified in section 502 (a) and paragraph (b) of § 29.502-1, or

(c) For the use of property constitutes personal holding company income in so far as such determination is based on the stock ownership requirement specified in section 502 (1) and $ 29.505-1, stock owned by an individual includes stock constructively owned by him as provided in section 503. For such purpose constructive ownership of stock shall be determined and applied in accordance with the rules provided in section 503 and §§ 29.503 (a)-(2) to 29.505 (a)-(7), inclusive, and § 29.503 (b)-(1). All forms of capital stock, however denominated, which represents the interests of shareholders, members, or beneficiaries of such corporation shall be taken into consideration.

§ 29.503 (a)-5 Stock not owned by individual. In determining the ownership of stock for any of the purposes set forth in § 29.503 (a)-(1), stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries. For example, if A and B, two individuals, are the exclusive and equal beneficiaries of a trust or estate, and if such trust or estate owns the entire capital stock of the M Corporation, and if the M Corporation in turn owns the entire capital stock of the N Corporation, then the stock of both the M Corporation and the N Corporation shall be considered as being owned equally by A and B as the individuals owning the beneficial interest therein. See also § 29.503 (a)-(6).

§ 29.503 (a)-(6) Family and partnership ownership. In determining the ownership of stock for any of the purposes set forth in § 29.503 (a)-(5), it shall be considered as owned by the stock owned, directly or indirectly, by or for his family or by or for his partner. For the purposes of such determination the family of an individual includes only his brothers, sisters (whether the whole, half, or half blood), spouse, ancestors, and lineal descendants.

The application of the family and partnership rule in determining the ownership of stock for the purposes set forth in § 29.503 (a)-(1) is illustrated by the following example:

Example. The M Corporation at some time during the taxable year held 1,500 shares of outstanding stock, 450 of which were held by various individuals having no relationship to one another and none of whom were partners, and the remaining 1,050 were held by 51 shareholders as follows:

<table>
<thead>
<tr>
<th>Relationship</th>
<th>Shares</th>
<th>Shares</th>
<th>Shares</th>
<th>Shares</th>
<th>Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual</td>
<td>A 10</td>
<td>B 10</td>
<td>C 10</td>
<td>D 10</td>
<td>E 10</td>
</tr>
<tr>
<td>Husband</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>His wife</td>
<td>AW 10</td>
<td>BW 10</td>
<td>CW 10</td>
<td>DW 10</td>
<td>EW 10</td>
</tr>
<tr>
<td>His brother</td>
<td>AB 10</td>
<td>BB 10</td>
<td>CB 10</td>
<td>DB 10</td>
<td>EB 10</td>
</tr>
<tr>
<td>His sister</td>
<td>AS 10</td>
<td>BS 10</td>
<td>CS 10</td>
<td>DS 10</td>
<td>ES 10</td>
</tr>
<tr>
<td>His daughter</td>
<td>AD 10</td>
<td>BD 10</td>
<td>CD 10</td>
<td>DD 10</td>
<td>ED 10</td>
</tr>
</tbody>
</table>

Total, or more than 50 percent—100

Individual A represents the obvious case where the head of the family owns the bulk of the family stock and naturally is the head of the group. Individual B represents the case where he is still head of the group because of the ownership of stock by his immediate family. Individual C and D represent cases where the stock of the head of the family was owned by minors, and the preponderance of holdings was by the minor's brother because of the preponderance of holdings on the part of relatives by marriage. Individual E represents the case where the preponderant holdings of others eliminate that individual from the group.

The method of applying the family and partnership rule as illustrated in the foregoing example also applies in determining the ownership of stock for the purposes stated in § 29.503 (a)-(1) and (b).

§ 29.503 (a)-(6) Options. In determining the ownership of stock for any of the purposes set forth in § 29.503 (a)-(1), if any person has an option to acquire stock, such stock may be considered as owned by such person. The term "option" as used in this section includes an option to acquire such an option and each one of a series of such options, so that the person who has an option on an option to acquire stock may be considered as the owner of the stock.

§ 29.503 (a)-(7) Application of family-partnership and option rules. The family and partnership rule provided in section 503 (a) (2) and § 29.503 (a)-(3) and the option rule provided in section 503 (a) (3) and § 29.503 (a)-(4) shall be applied:

(a) For the purpose stated in § 29.503 (a)-(1), if, but only if, the effect of such application is to make the corporation a personal holding company, or

(b) For the purpose stated in § 29.503 (a)-(1), if, but only if, the effect of such application is to make the amounts received under a personal service contract or from the sale of such a contract personally held company income.
The O Corporation in turn owns all the stock of the P Corporation.

Under the rights provided in section 503 (a) (1), relating to stock not owned by an individual, the stock in the P Corporation owned by the O Corporation is considered to be owned constructively by the M Corporation, the sole shareholder of the O Corporation. Such constructive ownership of the stock of the P Corporation is considered as actual ownership for the purpose of again applying such rule in order to make AW, the sole shareholder of the M Corporation, the constructive owner of the stock of the P Corporation. Similarly, the constructive ownership of the stock by AW is considered as actual ownership for the purpose of applying the family and partnership rule provided in section 503 (a) (2) in order to make A the constructive owner of the stock of the P Corporation, if such application is necessary for any of the purposes set forth in § 29.503 (a)–1. But the stock thus constructively owned by A may not be considered as actual ownership for the purpose of again applying the family and partnership rule in order to make another member of A's family, for example, A's father, the constructive owner of the stock of the P Corporation.

Example (2): A, an individual, owns all the stock of the S Corporation which has an option to acquire all the stock of the B Corporation owned by C, an individual, who is not related to A.

Under the option rule provided in section 503 (a) (3) the B Corporation may be considered as owning constructively the stock of the S Corporation owned by C. Such constructive ownership of the stock of the B Corporation is considered as actual ownership for the purpose of applying the rule provided in section 503 (a) (1), relating to stock not owned by an individual; in order to make B, the sole shareholder of the B Corporation, the constructive owner of the stock of the S Corporation. The stock thus constructively owned by B by reason of the application of the rule provided in section 503 (a) (1) likewise is considered as actual ownership for the purpose, if necessary, of applying the ownership rule provided in section 503 (a) (2), in order to make another member of B's family, for example, B's wife, the constructive owner of the stock of the S Corporation. However, the family and partnership rule could not again be applied as to make still another individual the owner of the stock of the S Corporation, that is, the stock constructively owned by BW could not be considered as actually owned by BW to make BW's father the constructive owner of such stock by a second application of the family and partnership rule.

§ 29.503 (a)–1 Option rule in lieu of family and partnership rule. If, in determining the ownership of stock for any of the purposes set forth in § 29.503 (a)–1, stock may be considered as constructively owned by an individual by an application of the ownership rule provided in section 503 (a) (2) (See § 29.503 (a)–3) and the option rule provided in section 503 (a) (3) (See § 29.503 (a)–4) stock shall be considered as constructively owned by the individual by reason of the application of the option rule.

The application of this section may be illustrated by the following example:

Example. Two brothers, A and B, each own 10 percent of the outstanding stock of the B Corporation, and A's wife, also owns 10 percent of the stock of such corporation, A's husband, B, has an option to acquire the stock owned by her at any time. It becomes necessary, for one of the purposes stated in § 29.503 (a)–1, to determine the stock ownership of B in the M Corporation.

If the family rule were the only rule that applied in the case, B would be considered, under that rule, as owning 10 percent of the outstanding stock of the M Corporation, namely, his own stock plus the stock owned by his brother. In that event, B could not consider as owning the stock held by AW since (1) A is a member of B's family and (2) the constructive ownership of such stock by A through the application of the family-partnership rule in this case is not considered as actual ownership so as to make B the constructive owner by a second application of the rule with respect to the ownership of the stock. (See § 29.503 (a)–6).

However, there is more than the family and partnership rule involved in this example. As the holder of an option upon the stock, A may be considered the constructive owner of such stock of the M Corporation owned by AW, namely, his own stock plus the stock owned by his brother, by application of the option rule, then under § 29.503 (a)–6, such constructive ownership by A is regarded as stock for the purpose of applying the family and partnership rule so as to make another member of A's family, for example, B, the constructive owner of the stock of the B Corporation, namely, his own stock plus 10 percent constructively owned by A as the holder of an option on the stock.

(Sec. 603. Stock ownership.)

(b) Convertible securities. Outstanding securities convertible into stock (whether or not convertible during the taxable year) shall be considered as outstanding stock:

(1) For the purpose of the stock ownership requirement provided in section 501 (a), but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such a subsection as personal holding company income.

(2) For the purpose of section 502 (a) relating to the use of property by shareholders, but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such a subsection as personal holding company income.

The requirement in paragraphs (1), (2), and (3) that all convertible securities must be included if any are to be included shall be subject to the exception that, where some of the convertible securities are convertible only after a later date than in the case of others, the class having the earlier conversion date may be considered, under section 501 (a), as personal holding company income.

The amounts used or irrevocably set aside to pay or to retire indebtedness of any kind incurred in order to Jersey, or to Jersey, of amounts are reasonable with reference to the size and terms of such indebtedness.

(c) Dividends paid after the close of the taxable year and before the 15th day of the month following the close of the taxable year, if claimed under this subsection in the case of amounts paid before the close of the taxable year, but only on the portion of such dividends which had been included in the computation of the basic surtax credit.
for the taxable year if distributed during such taxable year; but the amount allowed under this subsection shall not exceed either:  
(1) The undistributed Subchapter A net income for the taxable year computed without regard to this subsection; or  
(2) 10 per cent of the sum of—  
(A) the amounts distributed during the taxable year (reduced by the amount allowed under this subsection in the computation of the tax under Title I of the Revenue Act of 1938 in the computation of the tax under Title I of such Act for a taxable year beginning prior to January 1, 1939), and  
(B) the consent dividends credit for the taxable year.  
(3) Amounts distributed before January 1, 1946, in redemption of preferred stock outstanding before January 1, 1936 (including any preferred stock issued after January 1, 1934, in lieu of such previously outstanding preferred stock) if such distributions are made by a corporation the aggregate of whose gross sales and gross receipts arising from manufacturing, commercial, processing, and service operations during the four-year period immediately preceding the date of such distribution, the aggregate of its gross receipts from dividends, interest, royalties, annuities, and gains from the sale or exchange of stock or securities during such period.

Sec. 185. Distributions by personal holding companies. (Revenue Act of 1942, title I.)  
(g) Retroactive application. The amendments made by subsections (a) to (d), inclusive [the amendments of sections 115 (a), 115 (b), (c), and 506 (c), Internal Revenue Code], shall be effective with respect to distributions, which is a dividend solely by reason of the last sentence of section 115 (a) of the amped sections, made prior to the date of enactment of this Act by a corporation which, under the law applicable to the taxable year in which the distribution is made, is a personal holding company, or which, for the taxable year in respect of which it is made under section 504 (b) or section 506 (c) or a corresponding provision of the prior income tax law, is a personal holding company under the law applicable to such taxable year, respectively.  
(1) The corporation (under regulations prescribed by the Commissioner with the approval of the Board of Tax Appeals) files, within one year after the date of the enactment of this Act, a claim for the benefit of this section on account of such distribution.  
(2) Such claim is accompanied by signed consents made under oath by each person to whom the corporation made such distribution agreeing to the inclusion of the amount of such distribution to him in his gross income as a taxable dividend. If any such person is not in existence for the taxable year, or is under disability then the consent may be made by his legal representative; and  
(g) if filed is accepted by cash, or such other medium of payment as the Commissioner may by regulations authorize, in an amount equal to the amount that would be paid under section 504 or 144 or of the applicable revenue law to be deducted and withheld by the corporation if the distribution to the shareholder had been paid to the shareholder in cash as a dividend. The amount accompanied by such consent shall be credited against the tax under the applicable revenue law imposed by section 211 (a) or 231 (a) upon the shareholder.  
(3) Overpayments and deficiencies. If the refund or credit of any overpayment for any taxable year, to the extent resulting from the application of subsections (a) [amendment of section 23 (d), Internal Revenue Code] and (g) of this section is prevented on the date of the enactment of this Act or within one year from such date, then, notwithstanding the provisions of law or rule of law (other than this subsection and other than section 3701 of the Internal Revenue Code, as so amended, as prescribed by the United States Statutes, or such section as amended by section 815 of the Revenue Act of 1938, relating to adjacent provisions of subsections (e) and (g) of this section), there is a conclusive presumption on the date of the filing of the shareholders' consents referred to in subsection (e) or on the date of the filing of the claim referred to in subsection (g) (1) or within one year from the date of filing of such consents or claim, as the case may be, that such overpayment of any year from the date of the filing of such consents or claim, as the case may be.  
§ 29.504-1 Undistributed Subchapter A net income. The term "undistributed subchapter A net income" means the net income for the purposes of subchapter A (as defined in section 505 and § 29.505-1) minus (a) the amount of the dividends paid credit provided in section 27 (a) without the benefit of paragraphs (3), (4), relating to the debt, and paragraph (6), relating to the debt, credit, thereof (computed without its reduction, under section 27 (b), (1), by the amount of the credit provided in section 506 (a), relating to indebtedness of the United States and Government corporations), (b) amounts used or irrevocably set aside to pay or to retire indebtedness of any kind incurred prior to January 1, 1934, for taxable years beginning after December 31, 1940, by a corporation specified in section 504 (d), (c) dividends paid after the close of the taxable year and before the 15th day of the third month thereafter, if claimed under section 504 (c) in the return, but only to the extent and subject to the limitations contained in that section, and (d) amounts not shown in the computation of preferred stock outstanding prior to January 1, 1934 (including preferred stock subsequently issued in lieu thereof), but only if such distributions are made before January 1, 1934, in the years beginning after December 31, 1940, by a corporation specified in section 504 (d).  
In computing the dividends paid credit for the purposes of subchapter A of chapter 1, section 505 (a), the amount allowed under section 504 (c) in the computation of the tax under subchapter A for any preceding taxable year is considered a dividend paid in such preceding taxable year and not in the year of distribution.
trustees required by the provisions of a mandatory sinking fund agreement, will be consistent with the statutory requirement of reasonableness. To be considered reasonable it is not necessary that the plan of retirement provide for a retroactive setting aside of amounts not set aside prior to that in which the plan is adopted. However, if a voluntary plan was adopted prior to 1934, no adjustment is allowable in respect of the amounts set aside in the years prior to 1934.

(d) General. The burden of proof will rest upon the taxpayer to sustain the deduction claimed. Therefore, the taxpayer must furnish the information required by the return, and such other information as the Commissioner may require in substantiality of the deduction claimed.

§ 29.504-3 Retroactive application. If any distribution, which is a dividend solely by reason of the last sentence of section 115 (a), was made prior to October 21, 1942, by a corporation which, under the revenue law applicable to the taxable year in which the distribution was made, was a personal holding company under the law applicable to such taxable year, the corporation is entitled to a dividend paid credit for any taxable year in which, or with respect to which, the distribution was made.

(a) The corporation files with the Commissioner of Internal Revenue, Washington, D. C., attention Income Tax Unit, Records Division, within one year after October 21, 1942, a claim for the benefit of section 186 of the Revenue Act of 1942, on account of any distribution, which is a dividend by reason of the last sentence of section 115 (a), made before October 21, 1942;

(b) Such claim is accompanied by signed consents made on oath or affirmation on Form 972, as provided in § 29.504-5, by each shareholder from whom the corporation made such distribution, agreeing to the inclusion of the amount of such distribution as a taxable dividend in his gross income for the taxable year in which it is made; and

(c) Each such consent filed is accompanied by payment of an amount equal to that which would be required by section 143 (b) or 144 of the applicable revenue law to be deducted and withheld by the corporation if the amount of the distribution to the shareholder had been paid to the shareholder in cash as a dividend.

§ 29.504-4 Claim for benefit of section 186 of the Revenue Act of 1942—(a) General. A claim for the benefit of section 186 of the Revenue Act of 1942 must be filed within one year after October 21, 1942, claiming credit for any distribution, which is a dividend solely by reason of the last sentence of section 115 (a).

(b) Form of claim. The claim for such credit shall be made in duplicate, under oath or affirmation, on Form 972B, copies of which, upon request, may be procured from any collector.

(c) Contents of claim. The claim shall, in accordance with the provisions of this section and the instructions on the form, set forth the following information:

(1) The name and address of the corporation;

(2) Taxable year or years for which the benefit of a credit is claimed;

(3) Amount of distribution which is a dividend by reason of the last sentence of section 115 (a) and date of payment thereof;

(4) Amount of distribution previously allowed, if any, as a dividends paid credit, and amount of distribution previously disallowed as a dividends paid credit and for which signed consents accompany the claim;

(5) Whether the corporation was a personal holding company under the law applicable to the taxable year in which the distribution was made or for the taxable year in respect of which it was made under sections 504 (c) or 506 or a corresponding provision of a prior income tax law;

(6) Amount of tax to be eliminated, refunded, or credited; and

(7) Such other information as may be required by the claim form.

§ 29.504-5 Making and filing of consents. A consent shall be made in duplicate on oath or affirmation on Form 972 in accordance with these regulations and the instructions on the form or issued therefor by or on behalf of the shareholder to whom the corporation made the distribution. In the consent it must be agreed that such distribution shall be included as a taxable dividend in the gross income for the taxable year in which the distribution is made. A consent may be made at any time not later than one year after October 21, 1942. With each corporation must file two duly executed duplicate originals of each consenting shareholder’s consent, and a return on oath or affirmation on Form 972B, showing the class and number of shares of each class held at date of dividend payment, amount previously considered taxable, amount previously considered nontaxable, and all other information required by the form.

In the event that any consent filed by the corporation is made by a shareholder from whom, if the amount of the distribution in payment as a dividend, the corporation would have been required to deduct and withhold any amount as a tax under section 143 (b) or 144, such consent, when filed by the corporation, shall be procured by payment of the amount which would have been required to be deducted and withheld if the amount of the distribution had been paid in cash as a dividend. Such payment must be in one of the following forms:

(a) Cash;

(b) United States postal money order;

(c) Certified check drawn on a domestic bank; provided that the law of the place where the bank is located does not permit the certification to be rescinded prior to presentation;

(d) A cashier’s check on a domestic bank;

(e) A draft on a domestic bank or a foreign bank maintaining a United States branch and payable in United States funds.

The amount of such payment shall be credited against the tax imposed by section 211 (a) or 231 (a) upon the shareholder.

§ 29.504-6 Overpayments and deficiencies—(a) Overpayments. If, as a result of the application of section 186 of the Revenue Act of 1942, any overpayment is established or determined with respect to the personal holding company tax for any year, and if, on October 21, 1942, or within one year thereafter, such credit or refund would otherwise be prevented, then notwithstanding any other provision of law or rule of law (other than section 176 (b) of the Revenue Act of 1942), such overpayment shall be refunded or credited in the same manner as in the case of an income tax erroneously collected.

(b) Deficiencies. If, as a result of the application of section 186 of the Revenue Act of 1942, a deficiency is established or determined with respect to the personal holding company tax for any year, and if, on the date of the filing of the consent referred to in subsection (c) of that section, or on the date of filing of the claim referred to in subsection (g) (1) of that section, or within one year from the date of filing such consents or claim, as the case may be, the tax would be increased because of any other provision of law or rule of law, the deficiency shall be assessed and collected if assessment is made within one year from the filing of such consents or claim, as the case may be.

(c) Amounts not included in shareholder’s return. If a shareholder fails to include in his gross income for the proper taxable year the amount specified in section 186 (g) (2) of the Revenue Act of 1942, such failure shall have the same effect with respect to the deficiency resulting therefrom as is provided in section 272 (f) of the Internal Revenue Code with respect to a deficiency resulting from a mathematical error appearing on the face of the return.

Sec. 505. Subchapter A, Net Income [as amended, by secs. 211, 212, Rev. Act 1939; secs. 135 (b), 150 [(l), Rev. Act 1942]].

For purposes of section 115 and for the term “Subchapter A, Net Income” means the net income with the following adjustments:

(1) Additional deductions. There shall be allowed as deductions:

(1) Federal income, war-profits, and excess-profits taxes paid or incurred during the taxable year to the extent not allowed as a deduction under section 23; but not including the
tax imposed by section 169, section 503, or a section of a prior income-tax law corresponding to either of such sections.

(2) In lieu of the deduction allowed by section 23 (q), the deductions or gifts, the aggregate of which is means within the taxable year to or for the use ofDONEES described in section 22 (q), relating to the purposes described in section 22 (q) for the purposes therein specified, to an amount which does not exceed 15 per centum of the taxpayer's net income, computed without the benefit of this paragraph (3), and without the deduction of the amount disallowed under subsection (b) of this section.

The term "subchapter A net income" includes interest upon obligations of the United States, and obligations of a corporation organized prior to January 1, 1936, to take over the assets and liabilities of the estate of a deceased individual in liquidation of the liability of the corporation based on the liability of the decedent to make contributions or gifts to or for the use of donees described in section 22 (q) for the purposes therein specified, to the extent such liability of the decedent existed prior to January 1, 1934. No deduction shall be allowed under this paragraph (2) of this subsection for a taxable year for which a deduction is allowed under this paragraph (b).

(b) Deductions not allowed. The aggregate of the deductions allowed under section 23 (q), relating to expenses, and section 23 (q), relating to depreciation, which are allocable to the operation and maintenance of property owned or operated by the corporation only in the amount necessary to the extent such liabilities existed for expectation that the operation of the property would result in a profit, or that the property was held in the course of a business carried on bona fide for profit; and

(3) Either that there was reasonable expectancy that the operation of the property was necessary to the conduct of the business, or if none was received, that none was obtainable; and

(4) Either that the rent or other compensation received was the highest obtainable, or, if none was received, that none was obtainable;

(2) Net loss carry-over disallowed. The deduction for net operating losses provided in section 23 (q) shall not be allowed.

(d) Net capital loss carry-over denied. The net income shall be computed without regard to section 117 (e) (2).

§ 29.505-1 Subchapter A net income. The term "subchapter A net income" means, in the case of a domestic corporation, the gross income as defined in section 22 less the deductions provided in section 23 subject to the qualifications, limitations, and exceptions provided in section 505. In the case of a foreign corporation, whether resident or nonresident, which files or causes a return to be filed, the "subchapter A net income" means the net income from sources within the United States (gross income from sources within the United States as defined in section 119 and the regulations thereunder less statutory deductions) subject to the qualifications, limitations, and exceptions provided in section 505. In the case of a foreign corporation, whether resident or nonresident, which files or causes a return to be filed, the "subchapter A net income" means the net income from sources within the United States as defined in section 119 and the regulations thereunder less statutory deductions; the burden of proof will rest upon the taxpayer to sustain the deduction claimed. If, in computing its subchapter A net income, a personal holding company claims deductions for expenses and depreciation allocable to the operation and maintenance of property owned or operated by the company, in an aggregate amount in excess of the rent or other compensation received for the use of, or the right to use, the property, it shall attach to its income tax return a statement setting forth its claim for allowance of the additional deduction together with a complete statement of the facts and circumstances pertinent to its claim and the arguments on which it relies. Such statement shall set forth:

(1) The description of the property to which the deduction is claimed.
(2) The rent or other basis to the corporation and the nature and value of the consideration paid for the property;
(3) The name and address of the persons from whom acquired and the date thereof;
(4) The name and address of the person to whom leased or rented, or the person permitted to use the property, and the manner of shares of stock, if any, held by such person and the members of his family;
(5) The nature and gross amount of the rent or other compensation received for the use of, or the right to use, the property during the taxable year and for each of the five preceding years and the amount of the expenses incurred with respect to, and the amount of the compensation sustained on, the property for such years;
(6) Evidence that the rent or other compensation was the highest obtainable and, if none was received, a statement of the reasons therefor;
(7) A copy of the contract, lease or rental agreement;
(8) The purpose for which the property was used;
(9) The business carried on by the corporation with respect to which the property was held and the gross income, expenses, and net income derived from the conduct of such business for the taxable year and for each of the five preceding years;
(10) A statement of any reasons which existed for expectation that the operation of the property would result in a profit, or that the property was held in the course of a business carried on bona fide for profit.

§ 29.505-2 Illustration of computation of subchapter A net income, undistributed subchapter A net income, and surtax. The method of computation of the subchapter A net income, the undistributed subchapter A net income, and the surtax under subchapter A of chapter 2 may be illustrated as follows:

The following facts exist with respect to the O Corporation, a personal holding company which is on the cash receipts and disbursements basis, for the calendar year 1942:

The net income, as computed under chapter 1, amounts of $290,000.

Federal income tax imposed by sections 13 and 15 was paid March 15, 1942, in the amount of $17,500.

Contributions or gifts payment of which is made to or for the use of donees described in section 23 (q) for the purposes therein specified amount to $35,000, of which $10,000 is deducted in arriving at the net income under chapter 1.
Rent in the amount of $10,000 was received from the principal shareholder of the corporation for the use of a country estate which had been previously acquired from such shareholder in exchange for its capital stock. The expenses of the corporation allocable to the maintenance and operation of the country estate amounted to $80,000. The yearly depreciation on the depreciable property of the estate amounts to $5,000. The corporation has not established its right to claim the entire amount of the expenses and depreciation applicable to the estate as provided in section 655 (b) and $29,505-1.

Dividends paid by the corporation to its shareholders during the taxable year which are allowable as a credit under section 27 (a) amount to $125,000.

The amount used during the year to pay indebtedness incurred by the corporation prior to January 1, 1942, is $31,250.

On March 1, 1943, the corporation paid its shareholders a taxable dividend of $15,000 and in its return, on Form 1120H, it stated that its excess of aggregate tax credits under section 504 (c) of $12,500, that being 10 percent of the dividends paid during the taxable year 1942.

The subchapter A net income, the undistributed subchapter A net income, and the surplus are computed as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income under chapter l</td>
<td>$150,000</td>
</tr>
<tr>
<td><em>Add:</em> Contributions deductible in computing net income under section 91</td>
<td>$17,500</td>
</tr>
<tr>
<td>Aggregate of expenses and depreciation related to the country estate in excess of the income derived therefrom</td>
<td>$23,000</td>
</tr>
<tr>
<td>Net income computed without the benefit of a deduction for contributions and without the benefit of the amount disallowed under section 655 (b)</td>
<td>$225,000</td>
</tr>
<tr>
<td><em>Less:</em> Federal income tax</td>
<td>$17,500</td>
</tr>
<tr>
<td>Contributions deductible under section 655</td>
<td>$33,750</td>
</tr>
<tr>
<td>Aggregate of expenses and depreciation related to the country estate in excess of the income derived therefrom</td>
<td>$51,250</td>
</tr>
</tbody>
</table>

Subchapter A net income | $125,750

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends paid credit</td>
<td>$125,000</td>
</tr>
<tr>
<td>Amount used to pay indebtedness</td>
<td>$31,250</td>
</tr>
<tr>
<td><em>Total:</em></td>
<td>$156,250</td>
</tr>
<tr>
<td>Undistributed subchapter A net income before section 655 (c)</td>
<td>$17,500</td>
</tr>
<tr>
<td>Dividends paid (subject to limitation in section 655 (c))</td>
<td>$12,500</td>
</tr>
<tr>
<td>Undistributed subchapter A net income</td>
<td>$5,000</td>
</tr>
<tr>
<td>Amount taxable at 75 percent (not in excess of $5,250)</td>
<td>$2,000</td>
</tr>
<tr>
<td>Amount taxable at 50 percent ($5,250 minus $2,500)</td>
<td>$2,000</td>
</tr>
<tr>
<td>Surtax on $2,500 at 75 percent</td>
<td>$1,500</td>
</tr>
<tr>
<td>Surtax on $2,000 at 50 percent</td>
<td>$1,000</td>
</tr>
</tbody>
</table>
| *Total surtax:* | $4,000

Sec. 505. Deficiency dividends. Credits are allowed as amended by sec. 1, Pub. Law 84-188, approved March 17, 1941; secs. 185, 188 (d) (i), Rev. Act 1942).

(a) Credit against unpaid deficiency. If the amount of a deficiency with respect to the tax imposed by this subchapter for any taxable year has been established: (1) by a decision of the Board of Tax Appeals [known as the Board of Tax Appeals of the United States] which has become final; or (2) by a closing agreement made under section 7360; or (3) by a final judgment in a suit to which the United States is a party.

then a deficiency dividend shall be allowed against the amount of the deficiency so determined, unless paid as additional amounts, and additions to the tax provided by law not paid on or before the date when claim for claim for such credit or refund under subsection (d). The amount of such credit shall be 65 per centum of the amount of deficiency dividends, as defined in subsection (c), that are allowable as a credit under section 504 (c) of the Revenue Act of 1938, and shall be paid into the United States Treasury.

(b) For taxable year in which paid. Deficiency dividends paid in any taxable year (to the extent of the portion thereof with respect to which the credit under subsection (a), or the credit or refund under subsection (b), or both, of this section or section 407 of the Revenue Act of 1938, are allowed) shall not be allowed under section 504 (c) in the computation of the tax of the corporation for such year and succeeding years.

(c) For prior taxable year. Deficiency dividends paid in any taxable year (to the extent of the portion thereof with respect to which the credit under subsection (a), or the credit or refund under subsection (b), or both, of this section or section 407 of the Revenue Act of 1938, are allowed) shall not be allowed under section 504 (c) in the computation of the tax of the corporation for such year and succeeding years.

(d) Claims required. No deficiency dividends credit shall be allowed under subsection (a) and no credit or refund shall be made under subsection (b) unless (under regulations prescribed by the Commissioner with the approval of the Secretary) claim therefor is filed within sixty days after the date of the closing agreement or the date of the final judgment which the decision of the Board of Tax Appeals which has become final; or (3) by a closing agreement made under section 7360; or (4) by a final judgment in a suit to which the United States is a party.

then a deficiency dividend credit shall be allowed against the amount of the deficiency so determined, unless paid as additional amounts, and additions to the tax provided by law not paid on or before the date when claim for such credit or refund under subsection (d). The amount of such credit shall be 65 per centum of the amount of deficiency dividends, as defined in subsection (c), that are allowable as a credit under section 504 (c) of the Revenue Act of 1938, and shall be paid into the United States Treasury.

(e) Suspensions of running of statute. If the corporation files a notification, as provided in subsection (a), to stay collection on any part of a deficiency, either by agreement or otherwise, the running of the statute of limitations, or both, of this section or section 407 of the Revenue Act of 1938, shall be suspended until the claim for credit or refund under subsection (b), or both, of this section or section 407 of the Revenue Act of 1938, is allowed and the claim for credit or refund so allowed shall be paid into the United States Treasury.

(f) Stay of collection. In the case of any deficiency with respect to the tax imposed by this subchapter established as provided in subsection (a)—

(A) The collection of the deficiency and all interest, additional amounts, and additions to the tax and any suit for recovery of any part of such deficiency shall be stayed until the expiration of thirty days after the date of the closing agreement or the date on which the decision of the Board of Tax Appeals which has become final, as the case may be.

(B) If notification has been filed, as provided in subsection (a), the collection of such part of the deficiency as is not in excess of the credit allowed under subsection (a), or the credit which, in the case of a deficiency determined by agreement, is not in excess of the credit allowed under subsection (b), or both, of this section or section 407 of the Revenue Act of 1938; or the credit or refund under subsection (b), or both, of this section or section 407 of the Revenue Act of 1938, is allowed, shall not be stayed unless the claim for credit or refund so allowed is disallowed in part.

(g) Transfer of suit. If and as the case may be, a deficiency determined by agreement shall be deemed to be a deficiency determined by a decision of the Board of Tax Appeals which has become final, as the case may be, and no suit for recovery of any part thereof is permitted except by authority of the Board of Tax Appeals which has become final, as the case may be.
for which the collection of such amount is stayed.

(4) Credit or refund denied if fraud, etc. 
No deficiency dividend credit shall be allowed under subsection (a) and no credit or refund 
shall be made under subsection (b) if the election of the corporation or any 
journal contains a finding that any part of the 
deficiency is due to fraud with intent 
to evade or circumvent the provisions of this 
section. The corporation may, under certain conditions (see 
§ 29.506-3), be relieved from the payment of a 
deficiency in the surtax imposed by 
subsection A of chapter 2, or, if any portion 
of such deficiency has been paid, may 
be entitled, under certain conditions (see 
§ 29.506-4), to a credit or refund of such 
portion. The deficiency must be 
established in the manner specified in 
section 506 (a) (1), (2), or (3), and the dividends 
must be paid on the date so established or 
within days thereafter. For what con-
tinuates payment of a dividend, see § 29.27 
(2), (3), and (4).

The benefit of section 506 is not ex-
tended to the satisfaction of any interest, 
additional amounts, or additions to the 
tax paid by law with respect to the 
portion of the deficiency claimed 
adducibility as if that section had not been 
acted. The benefit is denied if the closing 
agreement, decision of the Tax Court of 
the United States, or judgment contains a 
finding that the payment of the deficiency 
is due to fraud with intent to evade the 
tax, or to failure to file a timely return 
without reasonable cause for such fail-
ure. See section 506 (1).

§ 29.506-2 Date when decision by Tax Court or court becomes final 
and date of closing agreement. The date upon which 
a decision by the Tax Court of the United States becomes final is prescribed in 
section 1140.

The date upon which a judgment of a 
court becomes final must be determined 
upon the basis of the facts in the 
picular case. Ordinarily, a judgment 
of the United States district court becomes 
final when the expiration of the time 
alowed for taking an appeal, if no such 
appeal is duly taken within such time; 
and a judgment of the United States 
Court of Claims becomes final upon the 
expiration of the time allowed for filing a 
petition for certiorari if no such 
petition is duly filed within such time.

The date of the closing agreement, 
made under section 3706, is the date such 
agreement is approved by the Secretary, 
the Under Secretary, or an Assistant 
Secretary.

§ 29.506-3 Credit against unpaid de-

deficiency—(a) General. If the amount of a 
deficiency with respect to the tax 
paid by law and the taxable year 
or years involved; (2) The amount of the unpaid de-

deficiency with respect to the tax 
paid by law and the taxable year or years 
volved; (3) The amount of the credit intended 
to be claimed as a deficiency dividends 
credit; and (4) Other information as may be 
required by the notification form.
§ 29.506-5 Claim for deficiency dividends credit or credit or refund.—

(a) General. A claim for a deficiency dividends credit or credit or refund, made under section 506 (a), relating to credit against unpaid deficiency and under section 506 (b), relating to credit or refund of deficiency paid, must be filed within 60 days after the date of the closing agreement, or the date upon which the decision of The Tax Court of the United States becomes final, as the case may be.

(b) Form of claim. The claim for a deficiency dividends credit, or credit or refund, shall be made in duplicate, under oath or affirmation, on Form 976, copies of which, upon request, may be procured from any collector.

(c) Contents. There shall be attached to and made a part of the claim a certified copy of the resolution of the board of directors, or other authority, authorizing the payment of the dividend credited or refund of the deficiency paid, as the case may be. In addition the claim shall, in accordance with the provisions of this section and the instructions on the form, set forth the following information:

1. The name and address of the corporation.
2. The place and date of incorporation.
3. The amount of the deficiency determined with respect to the tax imposed by subchapter A of chapter 2 and the taxable year or years involved; the amount of the unpaid deficiency or, if the deficiency has been paid in whole or in part, the date the amount thereof was paid and the amount thereof; a statement as to how the deficiency was established, if unpaid, or if paid in whole or in part, how it was established that any portion of the amount paid was a deficiency at the time when paid and in either case whether it was by closing agreement, Tax Court decision or court judgment and the date thereof, if established by a final judgment in a suit against the United States for refund, the date of payment of the deficiency, the date claim for refund was filed, and the date the suit was brought; if established by a Tax Court decision or court judgment a copy thereof shall be attached, together with an explanation of how the decision or judgment became final;
4. The amount and date of payment of the dividend with respect to which the claim for deficiency dividends credit, or credit or refund, is filed;
5. A statement setting forth the various classes of stock, the name and address of each shareholder, the class and number of shares held by each on the date of payment of the dividend with respect to which the claim is filed, and the amount of dividend paid to each shareholder;
6. The amount claimed as a deficiency dividends credit; and
7. Such other information as may be required by the claim form.

(d) Time and place of filing claim. The claim required by section 506 (d) and this section shall be filed with the Commissioner of Internal Revenue, D. C., attention Income Tax Unit, Records Division, within 60 days after the date of the closing agreement, or the date upon which the decision of The Tax Court of the United States becomes final, as the case may be.

§ 29.506-6 Effect of deficiency dividends on dividends paid credit. No duplication of credit or refund with respect to any "deficiency dividends" is permitted. If a corporation claims and receives the benefit of the provisions of section 506 of the Internal Revenue Code or section 497 of the Revenue Act of 1938 based upon a distribution of "deficiency dividends," that distribution does not become a part of the basic surtax credit for the purposes of subchapter A of chapter 2; nor is it made the basis of the 2% month carry-back credit provided for in section 504 (d).

§ 29.506-7 Suspension of statute of limitations and stay of collection.—

(a) Suspension of running of statute. If a corporation files a notification of its intent to have certain dividends considered as "deficiency dividends" as provided in section 506 (c), then the running of the statute of limitations upon the assessment and collection of the established deficiency and all interest, additional amounts, and additions to the tax paid by law, is suspended for a period of two years after the date of the filing of such notification.

(b) Stay of collection. The Internal Revenue Code provides that, except in case of jeopardy, the collection of the established deficiency and all interest, additional amounts, and additions to the tax paid by law, is stayed for a period of 60 days subsequent to the final determination of the amount thereof. If within such 60-day period the corporation files with the Commissioner the prescribed notification of intention to seek the benefit of section 506, the collection of the established deficiency, to the extent of the amount or part thereof determined by the corporation in such notification if not in excess of the amount allowable under section 506 (a), is, except in cases of jeopardy, stayed for a period of 60 days subsequent to the final determination of the amount thereof. The filing of a claim for a deficiency dividends credit under section 506 (d) effect a further stay of collection of that portion of the established deficiency covered by the claim if not in excess of the amount allowable under section 506 (a), until the date the claim is disallowed (in whole or in part) by the Commissioner. The Code further specifies that in the event the running of the statute of limitations has been stayed as above indicated no distrain or proceeding in Court shall be begun for the collection of the amount stayed during the period for which it is stayed. The Commissioner, standing the provisions of section 272 (b), may refrain from assessing the subchapter A deficiency (plus interest, additional amounts, and additions to the tax) until the claim for the deficiency dividends credit is disposed of. After such claim is allowed or rejected, either in whole or in part, the entire amount of the deficiency (plus interest, additional amounts, and additions to the tax) will be assessed, if not already assessed. The amount of the claim for the deficiency dividends credit to the extent allowed will be credited against the amount so assessed, and the remainder of the amount assessed will be collected in the usual manner.

§ 29.506-8 Retroactive application. For regulations relating to making and filing of the claims and contents referred to in subsections (d) (1) and (c) of section 186 of the Revenue Act of 1942, see §§ 29.504-3, 29.504-4, and 29.504-5.
§ 29.506-9 Overpayments and deficiencies. For the refund or credit of any overpayment, and the assessment or collection of any deficiency referred to in section 29 of the Revenue Act of 1942, see §29.504-6.

§ 29.506-10 Election to have a certain dividend considered as a deficiency dividend. Section 506 (j) is designed to be used particularly in those cases where a corporation was a personal holding company for certain taxable years beginning prior to January 1, 1942, and the personal holding company tax has been paid in whole or in part prior to October 21, 1942, for any case the corporation may elect to have the amount of a dividend paid within six months after October 21, 1942, to share in whole or in part prior to October 21, 1942, claiming the benefit of that section and in the case of the corporation, means, in the case of an insurance company—other than life or mutual—that its income, upon which the personal holding company tax has been paid for certain taxable years beginning within such 6-month period, as of the close of such year without diminution of the taxable year (computed as of the beginning of the taxable year, and the earnings and profits of the taxable year for which the dividend is paid); (b) the corporation is required to make a return under chapter 1 for the six months after October 21, 1942, to have the amount of a dividend paid within such 6-month period treated as a deficiency dividend; (c) the election must be made by the filing of a claim for credit or refund within such 6-month period; (d) the dividend must be paid prior to the filing of the claim for credit or refund and the shareholders to whom the distribution is made must include such distribution as a taxable dividend in their returns for the taxable year in which such distribution is made; (e) the credits and refunds shall be made as provided in section 322, without regard to section 322 (b) (relating to the limitations on the allowance of refunds or credits), or section 323 (c) (relating to the effect of petitions to the Tax Court of the United States on refunds or credits); (f) no credit or refund shall be made under section 506 (j), with respect to any amount of tax paid on or after October 21, 1942; and (g) no interest shall be allowed on the credit or refund.

§ 29.506-11 Claim for additional credit or refund for prior taxable year—(a) General. A claim for additional credit or refund under section 506 (j), relating to election to have a certain dividend treated as a deficiency dividend, must be filed within six months after October 21, 1942, claiming the benefit of that section by reason of a dividend paid within such 6-month period.

(b) Form of claim. The claim for additional credit or refund under this section shall be made in duplicate, on oath or affirmation form 970A, copies of which, upon request may be procured from any collector.

§ 29.506-12 Effect of election. If the corporation elects to have a distribution made within six months after October 21, 1942, the deficiency dividend as provided in section 506 (j), and files the claim required by that section:

(a) The credit or refund shall be computed, and credited or refunded without interest, as provided in section 506 (b) and at the rates provided therein or in section 506 (g), as the case may be.

(b) The dividends paid credit for the taxable year in which paid and for a taxable year shall be determined in the manner prescribed in section 506 (c) (2).

SEC. 607. MEANING OF TERMS USED [as amended by sec. 227 (a), Rev. Act 1933].

(a) General rule. The terms used in this subchapter shall have the same meaning as when used in chapter 1.

(b) Insurance companies other than life or mutual. Notwithstanding subsection (a), in cases where a corporation is a domestic insurance company, other than a life or mutual, the gross income as defined in section 84, as increased or decreased by the amount of losses incurred, as defined in section 254 (b) (6), and the amount of earnings and profits, as defined in section 254 (23) (7), and decreased by the amount deductible under section 254 (c) (7) (relating to tax-free interest).

§ 29.503-1 Return and payment of tax. A separate return is required for the surtax imposed by section 600. Such returns shall be made on Form 1120H. In the case of a personal holding company that is a domestic corporation, and the return is required to be made within the time provided by section 53 and in the case of a foreign corporation within the time provided in section 235. The tax shown by the corporation's surtax return must be paid in the case of a domestic corporation within the time provided in section 55 and in the case of a foreign corporation within the time provided in section 233. The same provisions of law relating to the period of limitations for assessment and collection which govern the taxes imposed by chapter 1 also apply to the surtax imposed under subchapter A of chapter 2. However, since the surtax imposed under subchapter A of chapter 2 is a distinct and separate tax from those imposed under chapter 1, the making of a return under chapter 1 will not start the period of limitations for assessment of the surtax imposed under subchapter A of chapter 2. If the corporation subject to section 500 fails to file a return the tax may be assessed at any time. It is also provided that in any case where the Commissioner holds a deficiency determination with respect to the tax imposed by section 500, he is required to follow the same procedure which applies to deficiencies in income tax under chapter 1. The provisions applicable to deficiencies in the administrative provisions applicable to the surtax imposed by section 500 are not confined to those contained in chapter 1 but embrace all administrative provisions of law which have any application to income taxes.

§ 29.503-2 Determination of tax, assessment, collection. The determination, assessment, and collection of the tax imposed by section 500, and the examination and collection of returns and claims in connection therewith, which may be made under such procedure as may be prescribed from time to time by the Commissioner.

SEC. 623. ENSURE ACCUMULATION OF SURPLUS.

Insure surplus on corporations which accumulate surplus to avoid surtax on shareholders, see section 602.
SEC. 610. FOREIGN PERSONAL HOLDING COMPANIES.
For provisions relating to foreign personal holding companies and their shareholders, see Subpart F of chapter 1.

SEC. 611. PRIORITY OF RETURNS.
For provisions with respect to return of overpayments of income tax, see subsection (a) (2) of section 55.

SUBPART F—DEFINITIONS

SEC. 3797. DEFINITIONS [as amended by secs. 120 (1), 511, Rev. Act 1942.]
(a) When used in this title, where not otherwise provided or manifestly incompatible with the intent thereof—
(1) Person. The term "person" shall be construed to mean and include an individual, a trust, estate, partnership, company, or corporation.

(2) Partnership and partner. The term "partnership" includes an association, joint-stock company, or corporation as including such an association, joint-stock company, or insurance company.

(3) Domestic. The term "domestic" when applied to a person, or a partnership means created or organized in the United States or under the laws of the United States or of any State thereof.

(4) Foreign. The term "foreign" when applied to a corporation or partnership means not created or organized within the United States.

(5) Stock. The term "stock" includes the share in an association, joint-stock company, or insurance company.

(6) Shareholder. The term "shareholder" includes a member in an association, joint-stock company, or insurance company.

(7) United States. The term "United States" when used in a geographical sense includes the District of Columbia, Alaska and Hawaii, and the District of Columbia.

(8) State. The word "State" shall be construed to include the Territories and the Districts of Columbia, where such construction is necessary to carry out provisions of this title.

(9) Secretary. The term "Secretary" means the Secretary of the Treasury.

(10) Commissioner. The term "Commissioner" means the Commissioner of Internal Revenue.

(11) Collector. The term "collector" means collector of internal revenue.

(12) Taxpayer. The term "taxpayer" means any person subject to a tax imposed by this title.

(13) Military or naval forces of the United States. The term "military or naval forces of the United States" includes the Marine Corps, the Coast Guard, the Army, the Navy, the Women's Army Auxiliary Corps, the Navy Nurse Corps, the Marine Corps, the Women's Marine Corps, and the Women's Reserve branch of the Naval Reserve.

(14) Withholding agent. The term "withholding agent" means any person required to deduct and withhold any tax under the provisions hereof.

(15) Husband and wife. As used in sections 22 (k), 23 (u), 25 (b), (2), (A), and (2), and 370, and the last sentence of section 401 (a) (1), if there be thereon referred to are divorced, wherever appropriate to the meaning of such sections, the term "wife" shall be read "former wife" and the term "husband" shall be read "former husband"; and, if the payments described in such sections are made by one, either of the wife or former wife to the husband or former husband instead of vice versa, wherever appropriate to the meaning of such sections, the term "husband" and the term "wife" shall be read "husband," and "wife.

(b) Includes and including. The terms "includes" and "including" when used in definition contained in this title shall not be deemed to exclude other things otherwise within the meaning of the term defined.

(c) Provisions. For other definitions, see the following:

Singular as including plural R.S. 1 (U.S.C., Title 1, § 1).

Plural as including singular, R.S. 1 (U.S.C., Title 1, § 1).

-Members as including feminine, R.S. 1 (U.S.C., Title 1, § 1).

-Officer, R.S. 1 (U.S.C., Title 1, § 1).

-Oath as including affirmation, R.S. 1 (U.S.C., Title 1, § 1).

Company or association as including successors and assigns, R.S. 5 (U.S.C., Title 1, § 6).

County as including parish, R.S. 2 (U.S.C., Title 1, § 2).

Vessels as including all means of water transportation, R.S. 3 (U.S.C., Title 1, § 3).

Vehicle as including all means of land transportation, R.S. 4 (U.S.C., Title 1, § 4).

29.3797-1 Classification of taxes.
For the purpose of classification under the Internal Revenue Code makes its own classification and prescribes its own standards of classification.

Local law is of no importance in this connection. Thus, a trust may be classed as a trust or as an association (and, therefore, as a corporation), depending upon its nature or its activities. (See § 29.3797-3.) The term "partnership" is not limited to the common law meaning of partnership, but is broader in its scope and includes groups not commonly called partnerships. (See § 29.3797-4.) The term "corporation" is not limited to the artificial entity usually known as a corporation, but includes also an association, a trust classed as an association because of its nature or its activities, a joint-stock company, an insurance company, and certain kinds of partnerships, R.S. 29.3797-2 and 29.3797-4.) The definitions, terms, and classifications, as set forth in section 3797, shall have the same respective meaning and scope in these regulations.

29.3797-2 Association. The term "association" is not used in the Internal Revenue Code in any narrow or technical sense. It includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or participants change, and the affairs of which, like corporate affairs, are conducted by a single individual, a committee, a board, or some other group, acting in a representative capacity. It is immaterial whether such organization is created by an agreement, a declaration of trust, a statute, or otherwise. It includes a voluntary association in a joint-stock company or association, a "business" trust, a "Massachusetts" trust, a "common law" trust, an "investment" trust (whether of the fixed or the manage-ment type), an insurance exchange operating through an attorney in fact, a partnership association, and any other type of organization (by whatever name known) which is not, within the meaning of the Code, a trust or an estate, or a partnership association.

If the conduct of the affairs of a corporation continues after the expiration of its charter, or the termination of its existence, it becomes an association.

§ 29.3797-3 Association distinguished from trust. The term "trust," as used in the Internal Revenue Code of the United States, includes a trust, usually created by will or declaration of the trustees or the grantor, the trustees of which take title to the property for the purpose of protecting or conserving it, or for the benefit of others, and not primarily for the benefit of beneficiaries.

The beneficiaries of such a trust generally do no more than accept the benefits thereof and are not, in the ordinary case, the voluntary planners or creators of the trust arrangement. Even though the beneficiaries do create such a trust, it is ordinarily done to preserve the property or for the benefit of others without undertaking any activity not strictly necessary to the attainment of that object.

As distinguished from the ordinary trust described in the preceding paragraph, there is an arrangement whereby the legal title to the property is conveyed to trustees (or a trustee) who, under a declaration or agreement of trust, hold and manage the property with a view to income or profit for the benefit of beneficiaries. Such an arrangement is designed (whether expressly or otherwise) to afford a medium whereby an income or profit-seeking activity may be carried on through an organization such as a voluntary association or a joint-stock company or a corporation, thus obtaining the advantages of those forms of organization without their disadvantages. The nature and purpose of a cooperative undertaking will differentiate it from an ordinary trust. The purpose will not be considered narrower than that which is formally set forth in the instrument under which the activities of the trust are conducted.

If a trust is an undertaking or arrangement conducted for income or profit, the capital or property of the trust being supplied by the beneficiaries, and if the trustees or other designated persons are, in effect, the managers of the undertaking or arrangement, whether the beneficiaries determine the objects for which the trust is to be employed or control them, the beneficiaries are to be treated as voluntarily joining or cooperating with each other in the trust, just as do members of an association, and the undertaking or arrangement is deemed to be an association classified by the Internal Revenue Code as a corporation.

However, the fact that the capital or property of the trust is not supplied by the beneficiaries in no sense converts the organization into an ordinary trust rather than as an association.

By means of such a trust the disadvantages of an ordinary partnership are
avoided, and the trust form affords the advantages of unity of management and continuity of existence which are characteristic of both associations and corporations. It also affords the advantages of capacity, as a unit, to acquire, hold, and dispose of property and the ability to sue and be sued by strangers or members, which are characteristic of corporations. And, consequently, affords the limitation of liability referred to as resemblance to the general property, or venture, and a partnership as known at common law, distinction is that between the activity or division and sale of a parcel of land, the vested in the trust is of no importance. It treats such a trust according to articles of association or a corporate agreement (or declaration) and ordinary, trust, the use of the trust form itself. The effectiveness in action in the case of a trust or of a corporation does not depend upon technical arrangements or devices such as the appointment or election of a president, secretary, treasurer, or other "officer," the use of a "seal," the issuance of certificates to the beneficiaries, the holding of meetings by managers or beneficiaries, the use of a "charter" or "by-laws," the existence of "control" by the beneficiaries over the affairs or organization, or upon other minor elements. They serve to emphasize the fact that an organization possessing them should be treated as a corporation, but they are not essential to such character. For the function of the benefits enjoyed by a corporation, as outlined above, are attained, in the case of a trust, by the use of the trust form itself. The Internal Revenue Code disregards the technical distinction between a trust agreement (or declaration) and ordinary, articles of association or a corporate charter, and all other differences of detail. It treats such a trust according to its essential nature, namely, as an association. This is true whether the beneficiaries form the trust or, by purchase or otherwise, acquire an interest in an existing trust.

The mere size or amount of capital invested in the trust is of no importance. Sometimes the activity of the trust is a small venture or enterprise, such as the division and sale of a parcel of land, the erection of a building, or the capital rental of an office building or apartment house; sometimes the activity is a trade or business on a much larger scale. The distinction is that between the activity or purpose for which an ordinary trust of the traditional type would be created, and the activity or purpose for which a corporation for profit might have been formed.

§ 39.3797-4 Partnerships. The Internal Revenue Code provides its own concept of a partnership. Under the term "partnership" it includes not only a partnership as known at common law, but, as well, a syndicate, group, pool, joint venture, or other unincorporated organizations on any general business, financial operation, or venture, and which is not, within the meaning of the Code, a trust, estate, or a corporation. On the other hand, a partnership under the term "corporation" an association or joint-stock company, the members of which may be subject to the personal liability of partners. If an organization is not interrupted by the death of a member or by a change in ownership of a participating interest during the course of a partnership, and its management is centralized in one or more persons in their representative capacities, such an organization is an association, taxable as a corporation. As to the character of the syndicate, seeیده ینا $29.3797-2 and 29.3797-3. The following examples will illustrate some phases of these distinctions:

(a) If A and B buy some acreage for the purpose of buying and selling real estate. If A, B, C, or D, an outside party (or any combination of them as long as the approval of each participant is not required for syndicate action), takes control of the money, property, and business of the syndicate. The syndicate is not terminated on the death of any of the participants, the syndicate is classified as an association.

(b) A, B, and C contribute $1,000 each, for the purpose of buying and selling real estate. If A, B, C, or D, an outside party (or any combination of them as long as the approval of each participant is not required for syndicate action), takes control of the money, property, and business of the syndicate. The syndicate is not terminated on the death of any of the participants, the syndicate is classified as an association.

§ 39.3797-5. Limited partnerships. A limited partnership is classified for the purposes of the Internal Revenue Code as an ordinary partnership. On the other hand, as an association taxable as a corporation, depending upon its character in certain material respects. If the organization is not interrupted by the death of a general partner or by a change in the ownership of his participating interest, and if the management of its affairs is centralized in one or more persons acting in a representative capacity, it is taxable as a corporation. For want of these essential characteristics, a limited partnership is to be considered as an ordinary partnership notwithstanding other characteristics conferred upon it by local law.

The Uniform Limited Partnership Act has been adopted in several States. A limited partnership organized under the provisions of the Code, and on any nonresident foreign corporation, is classified as an association. A limited partnership organized under the provisions of the Code, and in certain material respects.

§ 39.3797-6 Partnership association. A partnership association of the type authorized by the statutes of several States, such, for instance, as those of the State of Pennsylvania (Purdon's Penna. Stat. Ann., (Perm. Ed.), Title 59, ch. 3), having by virtue of the provisions under which it was organized, the characteristics essential to an association within the meaning of the Internal Revenue Code, is taxable as a corporation.

§ 39.3797-7 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 members is an insurance company, whether the fund for such purposes is created wholly by membership dues or partly by contributions from the employer. 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, but the income therefrom shall be included in the return of the corporation.

The character of business, and subject to State insurance laws are significant in determining the business which a corporation is authorized and intends to carry on, the character of the business actually done in the taxable year determines whether it is taxable as an insurance company under the Internal Revenue Code. For example, during the year 1942 the M Corporation, incorporated under the laws of the State of R, carried on the business of lending money in addition to guaranteeing the payment of principal and interest of mortgage loans. Of its total income for the year, one-third was derived from its insurance business of guaranteeing the payment of principal and interest of mortgage loans and two-thirds was derived from its noninsurance business of lending money. The M Corporation is not an insurance company for the year 1942 within the meaning of the Code and these regulations.

§ 39.3797-8 Domestic, foreign, resident, and nonresident persons. A domestic corporation for the purposes of the Code and these regulations is one created in the United States, including only the States, the territories of Alaska, and Hawaii, and the District of Columbia, or under the law of the United States or of any State or Territory, and a foreign corporation is one which is not domestic. A domestic corporation is a resident corporation even though it does no business and owns no property in the United States. A foreign corporation engaged in trade or business within the United States is referred to in these regulations as a resident foreign corporation, and a foreign corporation not engaged in trade or business within the United States, as a nonresident foreign corporation. A partnership engaged in trade or business within the United States is referred to in these regulations as a resident partnership, and a partnership not engaged in trade or business within the United States, as a nonresident partnership.

Whether a partnership is to be regarded as resident or nonresident for income tax purposes is a person created or organized. The term "nonresident alien," as used in these regulations, includes an individual and a nonresident alien fiduciary.

§ 39.3797-9 Fiduciary. A fiduciary is a term which applies to persons who occupy positions of peculiar confidence toward others, such as trustees, executors, and administrators. A fiduciary for income tax purposes is a person who holds in trust an estate to which another has a beneficial interest, or receives and controls income of another, as in the case of receivers. A committee or guardian of the property of an incompetent person is a fiduciary.
§ 29.3797-10 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. An agent is a power of attorney, is not a fiduciary within the meaning of the Internal Revenue Code, and when one or more provisions of the internal revenue laws, such as the statute of limitations, would otherwise prevent such correction. Corrections are authorized under section 3801 on motion of the Commissioner. If the correction would result in an allowance of a refund or credit for the year with respect to which the error was made, or the taxpayer, if the correction would result in an additional assessment for such year or a claim for refund in an amount inconsistent with the error. No correction is permissible unless the inconsistent position is adopted by a determination made on or after August 27, 1938.

§ 29.3801 (a) (1)–3 Closing agreement as a determination. For the purposes of section 3801, a closing agreement may take the form of a closing agreement authorized by section 3760. Such an agreement may relate to the total tax liability of the taxpayer for a particular taxable year or years or to one or more separate items affecting such liability. If it becomes necessary or desirable to effect a determination in order to obtain or accelerate an adjustment authorized by section 3801, a closing agreement may be used for such purpose—whatever a taxpayer and the Government have concurred in the disposition of an item or items. A closing agreement becomes final within the meaning of section 3801 on the date of its approval by the Secretary, the Under Secretary, or an Assistant Secretary.

§ 29.3801 (a) (1)–4 Final disposition of claim for refund as a determination. A determination may take the form of a final disposition of a claim for refund. Such disposition may result in a determination with respect to two classes of items, i.e., items included in the claim for refund and items applied by the Commissioner to offset the alleged overpayment. The time at which a disposition in respect of a particular item becomes final may depend not only upon what action is taken with respect to that item but also upon whether the claim for refund is allowed or disallowed.

(i) The taxpayer’s contention with respect to an item is sustained and with respect to other items is denied, so that the net result is an allowance of refund or credit; or

(ii) The taxpayer’s contention with respect to an item is sustained, but the Commissioner applies other items to offset the amount of the alleged overpayment so that the net result is a disallowance of refund or credit.

(2) The taxpayer’s contention in the claim for refund with respect to an item is sustained but the Commissioner applies other items to offset the amount of the alleged overpayment so that the net result is an allowance of refund or credit.

(b) Items with respect to which the taxpayer’s claim is disallowed. The disposition with respect to an item as to which the taxpayer’s claim for refund is disallowed becomes final upon the expiration of the time allowed by section 3772 for instituting suit on the claim for refund, unless suit is instituted prior to the expiration of such period if:

(1) The taxpayer’s claim for refund is unqualifiedly disallowed; or

(2) The taxpayer’s contention with respect to an item is denied and with respect to other items is sustained so that the net result is an allowance of refund or credit; or

(3) The taxpayer’s contention with respect to an item is sustained in part and denied in part. For example, if the taxpayer claims a deductible loss of $10,000 and a consequent overpayment of $2,500 and the Commissioner concedes that a deductible loss was sustained but in the amount of $5,000 only, or if a deductible loss of $10,000 was sustained, under the Commissioner’s computation but under the Commissioner’s computation but under the Commissioner’s computation but under the Commissioner’s computation, the consequent overpayment is only $2,500, the disposition of the claim for refund with respect to both the allowance of the $5,000 and the disallowance of the remaining $5,000, or the allowance of the $2,500 overpayment and the denial of the $800, becomes final upon the expiration of the time for instituting suit on the claim for refund unless suit is instituted prior to the expiration of such period.

(c) Items applied by the Commissioner in reduction of the refund or credit. If the Commissioner applies an item in reduction of the overpayment alleged in the claim for refund, and the net result is an allowance of refund or credit, the disposition with respect to the item so applied by the Commissioner becomes final upon the expiration of the time allowed by section 3772 for instituting suit on the claim for refund unless suit is instituted prior to the expiration of such period. If such application of the item results in the assertion of a deficiency, such action does not constitute a

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section 3761 of the Internal Revenue Code and the corresponding provisions of prior Revenue Acts (relating to compromises). Examples of such provisions are: Sections 275, 311 (b) and (c), 322 (b), 323 (a), 1117, 3772 of the Internal Revenue Code and the corresponding provisions of prior Revenue Acts (relating to periods of limitation); sections 272 (1) and 322 (c) of the Internal Revenue Code and the corresponding provisions of prior Revenue Acts (relating to effect of petition to The Tax Court of the United States on further deficiency letters or on credits or refunds); or (3) is made, stood, in the taxable year with respect to which the determination relates to such section and other than section 3761 of the Internal Revenue Code and the corresponding provisions of prior Revenue Acts (relating to closing agreements); and sections 3770 (a), 3774, and 3775 of the Internal Revenue Code and the corresponding provisions of prior Revenue Acts (relating to payments, refunds or credits after period of limitation has expired).

If the tax liability for the year with respect to which the error was made has been compromised under section 3761 of the Internal Revenue Code or the corresponding provisions of any prior Revenue Acts, or by more than one of such provisions, section 3801 may be applied to correct the effect of the error only as to the tax or taxes for the year with respect to which the error was made which correspond to the tax or taxes to which the determination relates. Thus, if the determination relates to the tax imposed by section 272 (1) of the Internal Revenue Code, the adjustment may be only with respect to the tax imposed by such section or by the corresponding provisions of any prior Revenue Acts, or by more than one of such provisions.

Section 3801 may be applied to correct the effect of the error only as to the tax or taxes for the year with respect to which the error was made which correspond to the tax or taxes to which the determination relates. Thus, if the determination relates to the tax imposed by such section or by the corresponding provisions of any prior Revenue Acts, or by more than one of such provisions.

Section 3801 may be applied to correct the effect of the error only as to the tax or taxes for the year with respect to which the error was made which correspond to the tax or taxes to which the determination relates. Thus, if the determination relates to the tax imposed by such section or by the corresponding provisions of any prior Revenue Acts, or by more than one of such provisions.

If the tax liability for the year with respect to which the error was made has been compromised under section 3761 of the Internal Revenue Code or the corresponding provisions of any prior Revenue Acts, or by more than one of such provisions, section 3801 may be applied to correct the effect of the error only as to the tax or taxes for the year with respect to which the error was made which correspond to the tax or taxes to which the determination relates. Thus, if the determination relates to the tax imposed by such section or by the corresponding provisions of any prior Revenue Acts, or by more than one of such provisions.

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Section 3801 may be applied to correct the effect of the error only as to the tax or taxes for the year with respect to which the error was made which correspond to the tax or taxes to which the determination relates. Thus, if the determination relates to the tax imposed by such section or by the corresponding provisions of any prior Revenue Acts, or by more than one of such provisions.

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If the tax liability for the year with respect to which the error was made has been compromised under section 3761 of the Internal Revenue Code or the corresponding provisions of any prior Revenue Acts, or by more than one of such provisions, section 3801 may be applied to correct the effect of the error only as to the tax or taxes for the year with respect to which the error was made which correspond to the tax or taxes to which the determination relates. Thus, if the determination relates to the tax imposed by such section or by the corresponding provisions of any prior Revenue Acts, or by more than one of such provisions.
Court of the United States in 1942. An adjustment is authorized with respect to the year 1934. If the taxpayer had returned the rent for both 1934 and 1935 and by a determination the rent assessed and paid for 1935 on account of the rent item, a similar adjustment is authorized.

Example. The husband assigned to his wife salary to be earned by him in the year 1940. The wife included such salary in her separate return and the husband claimed it. The Commissioner asserted a deficiency against the wife for 1940 with respect to the wife's tax for 1940. The wife included such salary in her return for 1940. The husband unsuccessfully contested the deficiency before The Tax Court in 1942. An adjustment is authorized with respect to the wife's tax for 1940.

§ 29.3801 (b)–2 Double allowance of a deduction or credit. Section 3801 (b) (2) applies if the determination relates to a deduction or credit which was erroneously allowed to the taxpayer a deduction or credit which was erroneously allowed to the same taxpayer for another taxable year or a related taxpayer for the same or another taxable year.

Example (1). A taxpayer in his return for 1937 claimed and was allowed a deduction for destruction of timber by a forest fire. Subsequently it was discovered that the forest fire occurred in 1939 rather than in 1937. After the expiration of the period of limitations for the assessment of a deficiency for 1939, the taxpayer filed a claim for refund for 1939 based on a deduction for the fire loss in that year. The Commissioner in 1942 allows the claim for refund. An adjustment is authorized with respect to the tax for 1940.

Example (2). The beneficiary of a testamentary trust in his return for 1936 claimed, and was allowed, a deduction for depreciation of the trust property. The Commissioner asserted a deficiency against the beneficiary for 1936 with respect to a different item and final decision of The Tax Court of the United States was rendered in 1938, so that the expiration of the period of limitations for the assessment of a deficiency for 1936, the taxpayer files a claim for refund for 1938 based on a deduction for the fire loss in that year. The Commissioner in 1942 allows the claim for refund. An adjustment is authorized with respect to the year 1937.

Example (3). The beneficiary of a testamentary trust in his return for 1936 claimed, and was allowed, a deduction for depreciation of the trust property. The Commissioner asserted a deficiency against the beneficiary for 1936 with respect to a different item and final decision of The Tax Court of the United States was rendered in 1938, so that the expiration of the period of limitations for the assessment of a deficiency for 1936. The trustee thereafter filed a claim for refund for 1938 on the same ground, The Commissioner in 1942 sustains the refund claim. An adjustment is authorized with respect to the beneficiary's tax for 1938.

§ 29.3801 (b)–3 Erroneous exclusion of item of gross income with respect to which tax was paid. Section 3801 (b) (3) applies if the determination requires the exclusion, from a taxpayer's gross income, of an item with respect to which tax was paid and the amount so excluded or omitted from the gross income of the same taxpayer for another taxable year or of a related taxpayer for the same or another taxable year.

Example (1). A taxpayer received payments in 1939 under a contract for the performance of services and included the payments in his return for that year. A closing agreement was made with the Board of Tax Appeals with respect to the liability of the taxpayer for 1939. The taxpayer subsequently filed claim for refund for the year 1939, asserting that he kept his books in the accrual basis and that as the payments accrued in 1938, they were properly taxable in that year. The claim for refund is allowed in 1942. An adjustment is authorized with respect to the tax for 1939.

The provisions of (b) of this section may be illustrated as follows:

Example. Assume the same facts as in the example under (a), except that, instead of the trustee's filing a refund claim, the Commissioner, relying upon the court decision, files a claim for refund of the deficiency against the beneficiary for 1938. The deficiency is sustained by final decision of The Tax Court of the United States in 1943. After the expiration of the period of limitations for the assessment of a deficiency against the beneficiary for 1938. An adjustment is authorized with respect to the beneficiary's tax for the year 1938.

The provisions of (c) of this section may be illustrated as follows:

Example. A taxpayer claimed in the return for 1939 a deduction for income distributed to the beneficiary. The income was included in the income of the beneficiary in his return for 1939. In 1940 the Commissioner asserts a deficiency against the trust on the ground that the amount distributed to the beneficiary represented a charge against the corpus of the trust and did not constitute a distribution of income. The income was included in the income of the beneficiary in his return for 1940. The Commissioner, relying upon the court decision, files a claim for refund. An adjustment is authorized with respect to the beneficiary's tax for the year 1940.
one in which gain or loss was not recognized;

Example (a). In 1932 the X Corporation claims that gain should have been recognized on the exchange in 1936 and therefore the property it received was worthless for income tax purposes. Its contention is confirmed by a closing agreement. No adjustment is authorized with respect to the tax of X Corporation in 1943, as there was no erroneous inclusion in or omission from the gross income of, or an erroneous recognition or nonrecognition of gain or loss of the property and the determination of the Commissioner in 1936 is therefore not changed with respect to the exchange in 1936. Moreover no adjustment is authorized with respect to taxpayer A, as he was not a party when the property was transferred, the property having been transferred in 1936, but, rather, to the property which he transferred in such exchange.

(b) In 1942 the X Corporation transfers the gain or loss on the sale of property to taxpayer Y Corporation or with respect to taxpayer Y Corporation, with respect to the year 1936, as the basis for computing gain on the sale depends upon the provisions of the tax law applicable in determining the basis for computing gain on the sale in 1936. In 1936, the property which taxpayer Y Corporation received had a fair market value of $10,000, in 1936 and in his return for that year treated such property as worthless. In 1936, the property was sold for an amount of $12,000. In 1936, the taxpayer sold the remaining 50 shares of stock of the X Corporation for $5,000, and reported a gain or loss in the amount of $5,000. The property then had a fair market valuation of $10,000. An adjustment is authorized with respect to the year 1936.

Example (b). In 1942 taxpayer A received 100 shares of stock of the X Corporation having a fair market value of $5,000, in exchange for a closing agreement. No adjustment is authorized with respect to the tax of taxpayer A, as there was no erroneous inclusion in or omission from the gross income of, or an erroneous recognition or nonrecognition of gain or loss of the property and the determination of the Commissioner in 1936 is therefore not changed with respect to the exchange in 1936. Moreover no adjustment is authorized with respect to taxpayer A, as he was not a party when the property was transferred, the property having been transferred in 1936, but, rather, to the property which he transferred in such exchange.

Example (c). A taxpayer, with respect to whom the determination is made, or with respect to which the determination relate to property which taxpayer A receives in a closing agreement. No adjustment is authorized with respect to the tax of taxpayer A, as there was no erroneous inclusion in or omission from the gross income of, or an erroneous recognition or nonrecognition of gain or loss of the property and the determination of the Commissioner in 1936 is therefore not changed with respect to the exchange in 1936. Moreover no adjustment is authorized with respect to taxpayer A, as he was not a party when the property was transferred, the property having been transferred in 1936, but, rather, to the property which he transferred in such exchange.

Example (d). In 1942 taxpayer A receives 100 shares of stock of the X Corporation having a fair market value of $5,000, in exchange for a closing agreement. No adjustment is authorized with respect to the tax of taxpayer A, as there was no erroneous inclusion in or omission from the gross income of, or an erroneous recognition or nonrecognition of gain or loss of the property and the determination of the Commissioner in 1936 is therefore not changed with respect to the exchange in 1936. Moreover no adjustment is authorized with respect to taxpayer A, as he was not a party when the property was transferred, the property having been transferred in 1936, but, rather, to the property which he transferred in such exchange.

Example (e). In 1942, the X Corporation transfers the property which taxpayer A received in 1936 and in respect of that transaction there was an erroneous nonrecognition of gain to taxpayer A, "the taxpayer," with respect to which the determination is made.

(d) Taxpayer A does not sell the stock but makes a gift of it to taxpayer B, who later sells the stock and claims the $10,000 basis, which contention is confirmed in a closing agreement. An adjustment is authorized with respect to his tax for the year 1943, as the basis for computing gain on the sale depends upon the provisions of the internal revenue laws applicable in determining the basis for computing gain upon the sale in 1936.

Example (f). In 1942 taxpayer A sells the stock which he received in 1936 and claims that, as gain should have been recognized on the exchange in 1936, the basis for computing the gain on the sale is $10,000. His contention is confirmed in a closing agreement. An adjustment is authorized with respect to his tax for the year 1936, as the basis for computing gain on the sale depends upon the provisions of the internal revenue laws applicable in determining the basis for computing gain upon the sale of the property then had a fair market valuation of $10,000. An adjustment is authorized with respect to the year 1936.

Example (g). In 1936, the X Corporation transfers the property which taxpayer A received in 1936 and in respect of that transaction there was an erroneous nonrecognition of gain to taxpayer A, "the taxpayer," with respect to which the determination is made.

Example (h). In 1937 taxpayer A sold property which he acquired at a cost of $5,000 in 1936, and in respect of that transaction there was an erroneous nonrecognition of gain to taxpayer A, "the taxpayer," with respect to which the determination is made.

Example (i). In 1937 taxpayer A sold property which he acquired at a cost of $5,000 in 1936, and in respect of that transaction there was an erroneous nonrecognition of gain to taxpayer A, "the taxpayer," with respect to which the determination is made.

Example (j). In 1937 taxpayer A sold property which he acquired at a cost of $5,000 in 1936, and in respect of that transaction there was an erroneous nonrecognition of gain to taxpayer A, "the taxpayer," with respect to which the determination is made.

Example (k). In 1937 taxpayer A sold property which he acquired at a cost of $5,000 in 1936, and in respect of that transaction there was an erroneous nonrecognition of gain to taxpayer A, "the taxpayer," with respect to which the determination is made.

Example (l). In 1937 taxpayer A sold property which he acquired at a cost of $5,000 in 1936, and in respect of that transaction there was an erroneous nonrecognition of gain to taxpayer A, "the taxpayer," with respect to which the determination is made.

Example (m). In 1937 taxpayer A sold property which he acquired at a cost of $5,000 in 1936, and in respect of that transaction there was an erroneous nonrecognition of gain to taxpayer A, "the taxpayer," with respect to which the determination is made.

Example (n). In 1937 taxpayer A sold property which he acquired at a cost of $5,000 in 1936, and in respect of that transaction there was an erroneous nonrecognition of gain to taxpayer A, "the taxpayer," with respect to which the determination is made.

Example (o). In 1937 taxpayer A sold property which he acquired at a cost of $5,000 in 1936, and in respect of that transaction there was an erroneous nonrecognition of gain to taxpayer A, "the taxpayer," with respect to which the determination is made.

Example (p). In 1937 taxpayer A sold property which he acquired at a cost of $5,000 in 1936, and in respect of that transaction there was an erroneous nonrecognition of gain to taxpayer A, "the taxpayer," with respect to which the determination is made.

Example (q). In 1937 taxpayer A sold property which he acquired at a cost of $5,000 in 1936, and in respect of that transaction there was an erroneous nonrecognition of gain to taxpayer A, "the taxpayer," with respect to which the determination is made.

Example (r). In 1937 taxpayer A sold property which he acquired at a cost of $5,000 in 1936, and in respect of that transaction there was an erroneous nonrecognition of gain to taxpayer A, "the taxpayer," with respect to which the determination is made.

Example (s). In 1937 taxpayer A sold property which he acquired at a cost of $5,000 in 1936, and in respect of that transaction there was an erroneous nonrecognition of gain to taxpayer A, "the taxpayer," with respect to which the determination is made.
inclusion of the item of interest in the gross income of the taxpayer for that year.

§ 29.3801 (b).-8 Existence of status of related taxpayer at time of the first maintenance of an inconsistent position. No adjustment by way of a deficiency assessment shall be made with respect to a related taxpayer unless the relationship existed both in the taxable year with respect to which the error was made and at the time of the taxpayer with whom the determination is made first maintained, in the manner described in this section, the inconsistent position with respect to the taxable year to which the determination relates.

If the inconsistent position is maintained in a return, claim for refund, or petition (or amended petition) to The Tax Court of the United States for the taxable year in respect of which the determination is made, the requisite relationship must exist on the date of filing such document. If the inconsistent position is maintained in a return, claim for refund, or petition (or amended petition) to The Tax Court of the United States for the taxable year in respect of which the determination is made first maintained, in the manner described in this section, the inconsistent position with respect to the taxable year to which the determination relates.

For the purpose of the adjustment authorized by section 3801, the period of limitation upon the making of an assessment for such taxable year with respect to which the error was made, as the case may be, shall be considered as if, on the date of the determination, one year remained before the expiration of such period, regardless of whether or not such period had expired prior to the date of the determination. The Commissioner thus has one year from the date of the determination to ascertain in respect of the tax to which the error was made, a notice of deficiency in respect of the amount of the adjustment where such amount is treated as if it were a deficiency. The issuance of such notice of deficiency, in accordance with the law and regulations applicable to the assessment of deficiencies, will suspend the running of the 1-year period of limitations provided by section 3801 (c). In accordance with the applicable law and regulations governing the collection of deficiencies (see section 726 (c) of the Internal Revenue Code and the corresponding provisions of prior Revenue Acts), the period of limitation for collection of such deficiency, whether the adjustment will commence to run from the date of assessment of such amount. Similarly, the taxpayer has a period of one year from the date of the determination within which to file a claim for refund in respect of the amount of the adjustment where such adjustment is treated as if it were an overpayment. Where the amount of the adjustment is treated as if it were a deficiency and the taxpayer chooses to pay such deficiency and contest it by way of claim for refund, the period of limitation upon filing such claim for refund does not commence to run from the date of such payment (see section 322 (b) of the Internal Revenue Code, the corresponding provisions of prior Revenue Acts).

€ 29.3801 (d).-1 Ascertainment of amount of adjustment. The amount of the adjustment shall be ascertained as follows:

(a) The tax previously determined for the taxpayer as to whom the error was made, for the taxable year with respect to which the error was made, as the case may be.

(b) Any amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax, including any amounts wrongfully collected, as deficiencies, and decreased by such amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax.

(c) Any amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax.

The tax previously determined may consist of tax for any taxable year beginning after December 31, 1931, imposed by chapter 1 and subchapters A, B, D, and E of title 26 of the United States Code, by the corresponding provisions of prior Revenue Acts, or by any one or more of such provisions.

(b) After the tax previously determined has been ascertained, a recomputation must then be made to ascertain the increase or decrease in tax, if any, resulting from the correction of the error. The difference between the tax previously determined and recomputed after correction of the error will be the amount of the adjustment.

With the exception of the items upon which the tax previously determined was based and the item or items in respect to which the error was made, no other item shall be considered in computing the amount of the adjustment. If the treatment of any item upon which the tax previously determined was based, or upon which the tax was recomputed after correction of the error, depends upon the amount of income (e.g., charitable contributions,
foreign tax credit, earned income credit, readjustment in these particular cases due to error, and a computation in conformity with the change in the amount of the income which results from the correct treatment of the item or items in respect of which the error is made.

Any interest or additions to the tax collected as a result of the error shall be taken into account in determining the amount of the adjustment.

**Example.** For the taxable year 1936 a married man with no dependents, who kept his books on the cash receipts and disbursements basis, filed a return disclosing gross income of $4,200, deductions amounting to $1,500, and a net income of $3,500. Included among other items in the gross income were salary in the amount of $1500 and rents accrued but not yet paid in the amount of $500. During the taxable year he donated $1000 to the American Red Cross and in his return claimed a deduction of $5,594.13 on account thereof, representing the maximum deduction allowable under the 15 percent limitation by section 123 (o), Revenue Act of 1936. In computing his net income he omitted interest income amounting to $600 and neglected to take a deduction of $300 on account of the interest income of $400. The return disclosed a tax liability of $8,565, which was assessed and paid. After the expiration of the period of limitations on the assessment of a deficiency or the allowance of a refund for 1936, the Commissioner in a suit for a refund based on his return of $1500 and deductions amounting to $3000 in the taxpayer's gross income for the year 1937 and asserted a deficiency for that year. As a result of a final determination of the amount of the tax due from the taxpayer. The amount of the adjustment was computed as follows:

- **Tax previously determined for 1936:** $8,565.00
- **Net income for 1938 upon which tax previously determined was based:** $15,000.00
- **Less: Rents erroneously included:** $500.00
- **Balance:** $9,565.00
- **Adjustment for contributions (add 15 percent of $9,500):** $1,456.50
- **Net income as adjusted:** $7,108.50
- **Tax as recomputed:** $7,108.50
- **Tax previously determined:** $8,565.00
- **Amount of adjustment to be refunded or credited:** $1,456.50

In accordance with the provisions of section 3801 (d), the recomputation to determine the amount of the adjustment does not take into consideration the item of $600 representing interest received, which was omitted from gross income, or the item of $4500 representing interest paid, for which no deduction was allowed.

**Example (2).** Assume that a taxpayer included in his net income he omitted interest income of $1500. When the return was filed a refund claim for the amount of the interest income was made. A suit for refund was filed by the taxpayer for the amount of the adjustment. The amount of the adjustment was $9000. The suit was brought on the ground that there was no overpayment for the year 1936 resulting from the failure to take such deduction.

If the Commissioner refused the amount of the adjustment under section 3801, the amount so refused may not subsequently be recovered by the Commissioner in a suit for a refund based on his return of $1500 and deductions amounting to $3000 in the gross income of the taxpayer for the year 1937. If the taxpayer in his return had included the item of $1500 and the amount of the adjustment had been $9000, the amount of the adjustment would have been $8,500. The amount of the adjustment is considered as an overpayment, it may be credited, under the applicable law and regulations thereunder, against any income or excess-profits tax, or installment thereof, due from the taxpayer. Likewise, if the amount of the adjustment is considered as a deficiency, any overpayment by the taxpayer of income or excess-profits tax may be credited against the amount of such adjustment in accordance with the applicable law and regulations thereunder. (See section 322 of the Internal Revenue Code and the corresponding provisions of prior revenue acts.) Accordingly, it may be possible in one transaction between the Commissioner and the taxpayer to settle the taxpayer's tax liability for the year with respect to which the determination is made and to make the adjustment under section 3801 for the year with respect to which the error was made.

**Section 3811. MENTION OF EFFECT OF LIMITATION AND OTHER PROVISIONS IN INCOME TAX CASES.**

(1) No adjustment for years prior to 1932. No adjustment shall be made under this section in respect of any taxable year beginning prior to January 1, 1932.

In pursuance of the Internal Revenue Code, as amended, the foregoing regulations prescribe for taxable years beginning after December 31, 1941, and Regulations 103, as amended, insofar as they relate to income taxes for taxable years beginning after December 31, 1941, are hereby superseded.

 Approved: October 26, 1943.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

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